

TRANSCRIPT OF RECORD.

SUPREME COURT OF THE UNITED STATES.

OCTOBER TERM, 1922.

No. 727.

NORFOLK SOUTHERN RAILROAD COMPANY, APPELLANT,

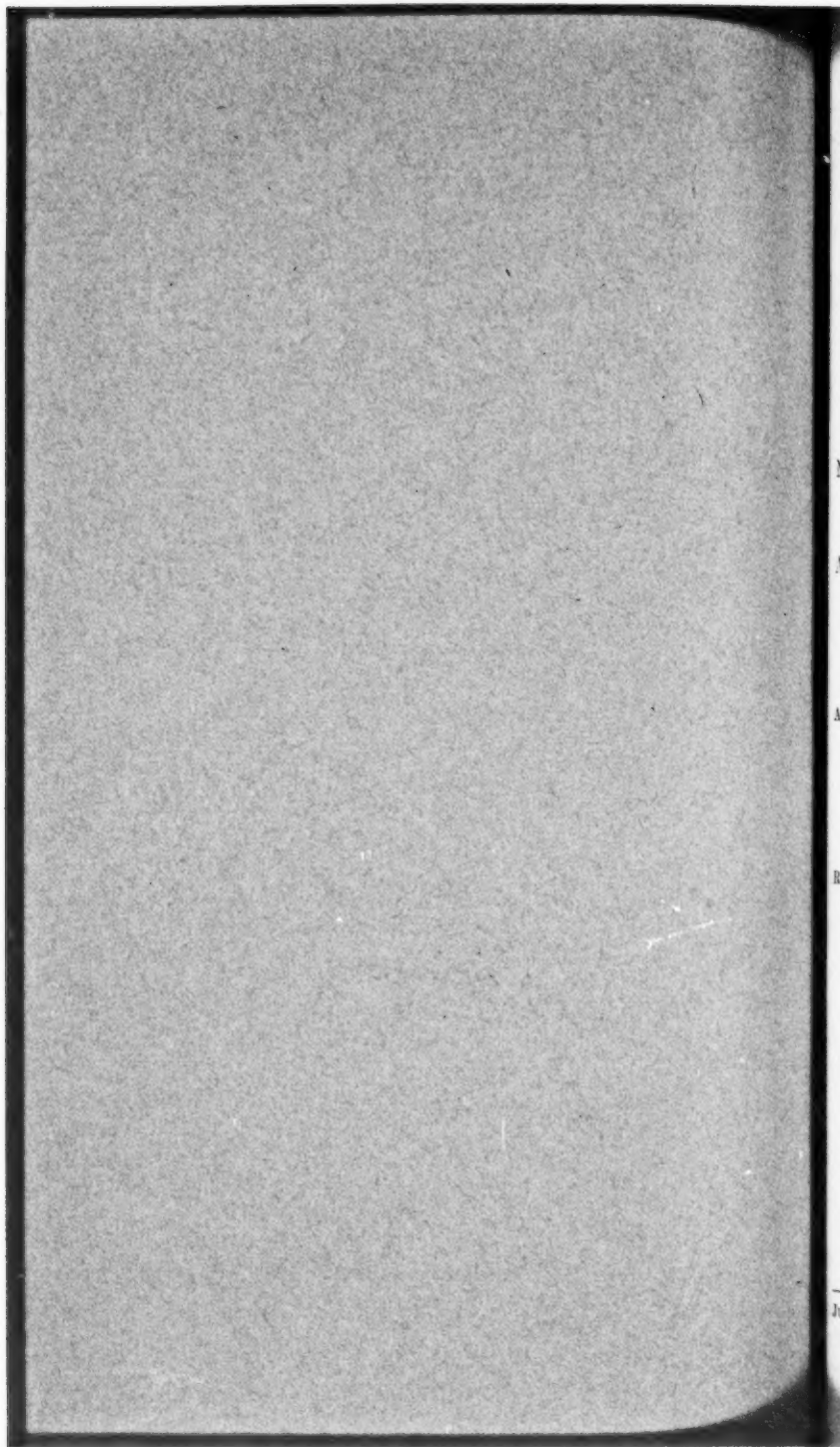
vs.

**A. D. WATTS, COMMISSIONER OF REVENUE, AND JAMES S.
MANNING, ATTORNEY GENERAL OF THE STATE OF
NORTH CAROLINA.**

**APPEAL FROM THE DISTRICT COURT OF THE UNITED STATES FOR
THE EASTERN DISTRICT OF NORTH CAROLINA.**

FILED DECEMBER 11, 1922.

(29,277)



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TRANSCRIPT OF RECORD.

In the District Court of the United States for the Eastern District of North Carolina.

At a District Court of the United States for the Eastern District of North Carolina begun and held at the court-house, in the city of Raleigh, on the fourth Monday after the fourth Monday in October, being the 20th day of November, in the year of our Lord one thousand nine hundred and twenty-two.

Present: The Honorable Henry G. Connor, Judge of the District Court for the Eastern District of North Carolina.

Among others were the following proceedings, to-wit:

In Equity.

NORFOLK SOUTHERN RAILROAD COMPANY

vs.

A. D. WATTS, Commissioner of Revenue, and JAMES S. MANNING, Attorney General of the State of North Carolina.

Bill of Complaint.

Filed April 15, 1922.

In the District Court of the United States for the Eastern District of North Carolina.

In Equity.

No. 450.

NORFOLK SOUTHERN RAILROAD COMPANY, Complainant,

vs.

A. D. WATTS, Commissioner of Revenue, and JAMES S. MANNING, Attorney General of the State of North Carolina, Defendants.

To the Honorable the Judge of the District Court of the United States for the Eastern District of North Carolina:

Norfolk Southern Railroad Company, a corporation originally created, organized and existing under the laws of the State of Virginia, a citizen and resident of the State of Virginia, brings this its bill against A. D. Watts, individually and as Commissioner of Revenue for North Carolina, and James S. Man-

ning, individually and as Attorney General for North Carolina, citizens and residents of the said State of North Carolina, and thereupon complains and says:

1. Complainant, Norfolk Southern Railroad Com-pany, is a corporation, originally created, organized and existing under and by virtue of the laws of the State of Virginia is a citizen and resident of the State of Virginia, authorized by its charter to conduct and carry on the business of a common carrier of freight and passengers by railroad, not only within the State of Virginia, but beyond its borders, and to engage in interstate and foreign commerce.

2. Defendant, A. D. Watts, is a citizen and resident of the State of North Carolina, holds the office of Commissioner of Revenue, is charged, under the statutes of North Carolina, with the duty of collecting the taxes authorized to be laid and levied under Schedule D, Chapter 34, Public Laws, 1921, being an act entitled "An Act to Raise Revenue," ratified the 8th day of March, 1921, and the amendments and supplements thereto. Said A. D. Watts, as an individual, is a citizen of the Western District of North Carolina; his official residence is at the capital of the State, the City of Raleigh, in the Eastern District of said State. James S. Manning is the Attorney General of the State of North Carolina, is a citizen and resident of said State, and is charged with certain duties in the collection of income taxes under said statute; his individual and official residence is at Raleigh, in the Eastern District of said State.

3. This is a suit in equity, arising under the constitution and laws of the United States, the benefit and protection of which complainant especially sets up and claims. Matters are also involved arising under the constitution and laws of North Carolina, of which matters this court has jurisdiction by reason of diverse citizenship of the parties. The amount in controversy in this case, exclusive of interest and cost, exceeds the sum and value of Three Thousand Dollars, as will be more specifically hereinafter shown.

4. Complainant owns a line of railroad extending from the City of Norfolk, in the State of Virginia, to the City of Charlotte, in the State of North Carolina, together with numerous branch lines, leading from said main line, and has under lease for 91 years, 4 months, from September 1, 1904, a line of railroad owned by Atlantic & North Carolina Railroad Company, extending from Morehead City to Goldsboro, in said State. It has under lease for 99 years from May 20, 1920, a line of railroad owned by Durham & South Carolina Railroad Company, extending from Duncan to Durham, in said State, and had under lease during the year 1921 a line of railroad owned by Carthage & Pinehurst Railroad Company, extending from Pinehurst to Carthage in said State. All of said leased railroads connect with the line of railroad owned by plaintiff. Said lines of railroad are operated by steam, and constitute plaintiff's steam division.

5. Plaintiff owns a line of railroad which is equipped and operated electrically, which is located entirely in Virginia,

and is known as plaintiff's electric division, and connects with its steam division.

Said lines of railroad constitute what is known as "Norfolk Southern Railroad."

During the year 1921, plaintiff conducted and carried on over said lines of railroad, and each and every of them, the business of transporting, as a common carrier by railroad, passengers and property from one state to another, and to and from foreign nations, and was during said year engaged in commerce among the states and with foreign nations; was and is, in the operation of said railroad, subject to the provisions of the Act of Congress approved February 4, 1887, the supplements and amendments thereto, known as the Interstate Commerce Act.

5. Plaintiff is, and was during the year 1921, required by law to keep its accounts according to the standard classification of accounting of Interstate Commerce Commission, and has duly made report of its business of all kinds to the Interstate Commerce Commission in accordance with the Interstate Commerce Act.

Under the rules of the Interstate Commerce Commission plaintiff in making report of the results of its operations for the year 1921 combined the operation of its electric and steam divisions. Plaintiff, however, as a matter of information, was permitted to keep the operating revenues and expenses of the two divisions separate.

6. Atlantic & North Carolina Railroad Company is a corporation created under the laws of the State of North Carolina and owns a line of railroad extending from Morehead City to Goldsboro; Durham & South Carolina Railroad Company is a corporation organized and existing under the laws of the State of North Carolina and owns a line of railroad extending from Duncan to Durham in said State; Carthage & Pinchurst Railroad Company, created under the laws of North Carolina, owns a line of railroad extending from Pinchurst to Carthage, in said State.

Each and every of said companies prior to January 1, 1921, leased their said lines of railroad to this plaintiff for a term of years as hereinbefore set out, except that the lease of the Carthage & Pinchurst Railroad Company expired prior to January 1, 1921, and the operation thereof was continued (notwithstanding the expiration of said lease) until plaintiff could apply to the Interstate Commerce Commission and obtain authority to abandon the same in accordance with the terms of the Interstate Commerce Act, and plaintiff operated the said line of railroad under said lease, paying rent therefor during the year 1921.

7. Neither of said companies were, as common carriers, engaged in commerce among the States or with foreign nations and were not required to keep their records in accordance with the standard classification of accounting of Interstate Commerce Commission.

8. The laws enacted by the General Assembly of North Carolina for raising revenue for the support of the State and its political sub-

7 divisions are set out in what is known as the "Revenue Act," being Chapter 34 of the Public Laws, 1921, and the amendments and supplements thereto.

9. Schedule D of said Act, known as the "Income Tax Act of 1921," and the supplements and amendments thereto, undertake to provide a scheme and plan for levying and collecting a tax upon the "net income" of the citizens of the State, and of non-residents doing business in the State, in accordance with the authority contained in the constitution of the State, Article V, Section 3, which provides:

"Laws shall be passed taxing, by a uniform rule, all moneys, credits, investments in bonds, stocks, joint-stock companies, or otherwise; and, also, all real and personal property, according to its true value in money: Provided, notes, mortgages, and all other evidence of indebtedness given in good faith for the purchase price of a home, when said purchase price does not exceed three thousand dollars, and said notes, mortgages, and other evidence of indebtedness shall be made to run for not less than five nor more than twenty years, shall be exempt from taxation of every kind: Provided, that the interest carried by such notes and mortgages shall not exceed five and one-half per cent. The general assembly may also tax trades, professions, franchises, and income: "Provided, the rate of tax on incomes shall not in any case exceed six per cent (6%), and there shall be allowed the following exemptions, to be deducted from the amount of annual incomes, to wit: for a married man with a wife living with him, or to a widow or widower having minor child or children, natural or adopted, not less than \$2,000; to all other persons not less than \$1,000, and there may be allowed other deductions (not including living expenses) so that only net incomes are taxed."

10. Sections 201 and 202 of said schedule provide as follows:

"Corporations.—Every corporation organized under the laws of this State shall pay annually a franchise or excise tax, with respect to carrying on or doing business, equivalent to three per cent of the entire net income of such corporation, as herein defined, received by such corporation during the income year; and every foreign corporation doing business in this State shall pay annually a franchise or excise tax equivalent to three per cent of a proportion of its entire net income, to be determined according to the following rules:

"In case of a company other than companies mentioned in the next succeeding section, deriving profits principally from the ownership, sale, or rental of real estate or from the manufacture, sale, or use of tangible personal property, such proportion of its entire net income as the fair cash value of its real estate and tangible personal property in this State on the date of the close of the fiscal year of such company in the income year is to the fair cash value of its entire real estate and tangible personal property then owned by it, with no deduction on account of incumbrances thereon.

"In case of a corporation deriving profits principally from the

holding or sale of intangible property, such proportion as its gross receipts in this State for the year ended on the date of the close of its fiscal year next preceding is to its gross receipts for such year within and without the State.

9 "Railroads and Public Service Corporations.—The basis of ascertaining the net income of every corporation engaged in the business of operating a steam or electric railroad, express service, telephone or telegraph business, or other form of public service, when such company is required to keep records according to the Standard Classification of Accounting of the Interstate Commerce Commission, shall be the 'net operating income' of such corporations as shown by their records kept in accordance with that standard classification of accounts, when their business is wholly within this State, and when their business is in part within and in part without the State their net income within this State shall be ascertained by taking their gross 'operating revenues' within this State, including in their gross 'operating revenues' within this State the equal mileage proportion within this State of their interstate business and deducting from their gross 'operating revenues' the proportionate average of 'operating expenses,' or 'operating ratio,' for their whole business, as shown by the Interstate Commerce Commission standard classification of accounts. From the net operating income thus ascertained shall be deducted 'uncollectible revenue,' and taxes paid in this State for the income year, other than income taxes and war profits and excess profits taxes, and the balance shall be deemed to be their net income taxable under this act."

11. The net income of all corporations doing business in the State, both domestic and foreign, except those "engaged in the business of operating a steam or electric railroad, express service, telephone or telegraph business, or other form of public service, when such
10 company is required to keep records according to the standard classification of accounting of the Interstate Commerce Commission, which, or the proportion of which, in the case of foreign corporations, is subject to a tax of three per cent, is ascertainable according to the provisions of Sections 301 to 307 of said schedule, both inclusive. Said sections are set out in full in Exhibit A, hereto attached.

12. Only those corporations which are "engaged in the business of operating steam or electric railroads, express service, telephone or telegraph business, or other form of public service, when such company is required to keep records according to the standard classification of accounting of the Interstate Commerce Commission," are in order to ascertain their net income subject to the provisions of Section 202 of Schedule D. The corporations described in Section 202, for the purpose of ascertaining their "net income" taxable under the act, are authorized to increase or decrease their so called "net operating income" by an addition or deduction of, as to railroads wholly within the state, the whole, and as to those railroads partly within and partly without the state an equal mileage propor-

tion within the state of any credit or debit balance received or paid as the case may be on account of car hire.

13. Only those corporations which are engaged in:

(a) The transportation of passengers or property wholly by railroad, or partly by railroad and partly by water, when both are used under a common control, management or arrangement for a continuous carriage or shipment; or

(b) The transportation of oil or other commodity, except water and except natural or artificial gas, by pipe line, or partly by pipe and partly by railroad or by water; or

(c) The transmission of intelligence by wire or wireless from one state or territory of the United States, or the District of Columbia, to any other state or territory of the United States or the District of Columbia, or from one place in a territory to another place in the same territory, or from any place in the United States through a foreign country to any other place in the United States, or from or to any place in the United States to or from a foreign country, but only in so far as such transportation or transmission takes place within the United States, are required to keep their records according to the Standard Classification of Accounting of the Interstate Commerce Commission.

14. Plaintiff is informed, believes and alleges that there are corporations organized under the laws of North Carolina and corporations not organized under the laws of North Carolina, which are engaged in North Carolina in the business of operating steam or electric railroads, express service, telephone or telegraph business, or other form of public service one or the other, and which are not required to keep records according to the Standard Classification of Accounting of the Interstate Commerce Commission.

12 15. Plaintiff, under the leases which it holds and under which it operates the lines of railroad owned by Atlantic & North Carolina Railroad Company, Durham & South Carolina Railroad Company and Carthage and Pinehurst Railroad Company, is obligated to pay as rent for the continued use of said properties in its trade or business, certain sums of money, and as to the Atlantic & North Carolina Railroad Company, this rent will be increased by the amount of income tax which said company will pay upon its income, and during the income year 1921, paid for such use of said properties the sum of \$160,365.90, which it is contended by the Commissioner of Revenue shall not be deducted from its gross revenue in the State, although such deductions are allowed other corporations.

Substantially the entire income of said three companies is the amount which plaintiff is obligated to pay to them as rent for the continued use of their businesses in its trade or business.

As said statute stands, this plaintiff will have to pay a tax of three per cent upon the amount which it will pay to said companies as rent, and said companies will have to pay an income tax upon that

part of said rent paid to them by this plaintiff, after making therefrom the deductions allowed under Section 306 of said Schedule D. This company has not taken, nor is it taking title to, nor has it any equity in the properties of said companies.

16. As plaintiff is informed, believes and alleges, no other corporation, domestic or foreign, renting property for use in its trade or business, is under said Schedule D required to pay an income tax upon the amount which it pays as rent for property used in its business and at the same time the person or corporation owning the leased property is required to pay an income tax upon the rent so received, unless it be some other corporation required to keep its records in accordance with the Standard Classification of Accounting of the Interstate Commerce Commission.

17. If plaintiff be allowed to make from its gross income the deductions mentioned and set out in Schedule D which are allowed to all domestic and foreign corporations except those required to keep their records according to the Standard Classification of Accounting of the Interstate Commerce Commission, this plaintiff will have no net income subject to tax for the income year ended December 31, 1921.

If this plaintiff be allowed to make from its gross income as defined in Schedule D, Sections 301 to 305, both inclusive, or from that part of said gross income which is derived from business done wholly within said State, together with a mileage proportion of that part of its business done partly within and partly without the same, the deductions set forth in Section 306 that are allowed individuals and corporations, both domestic and foreign, excepting those required to keep their records according to the Standard Classification of Accounting of Interstate Commerce Commission, or that part of such items which are expended wholly within the State, and a mileage proportion of those partly within and partly without the State, this plaintiff will have no net income for the income year 1921, subject to taxation.

18. Railroad companies engaged in commerce among the states, or with foreign nations, operating lines of railroad located partly within and partly without the State of North Carolina, required to keep their records in accordance with the Standard Classification of Accounting of the Interstate Commerce Commission, making reports to the Interstate Commerce Commission, in such reports are required to show their:

- (a) Total Railway Operating Revenue;
- (b) Total Revenue from Miscellaneous Operations;
- (c) Total Railway Operating Expenses; and
- (d) Total Expenses of Miscellaneous Operations.

Plaintiff is advised and so alleges that the terms gross "operating revenue" and gross "operating expenses" as used in said Section 202, if they mean anything, were intended to mean:

(a) As to "operating revenue," that sum which is obtained by the addition of the total revenue derived from railway and miscellaneous operation.

(b) As to "operating expenses," that sum which is obtained by the addition of the total expended in railway and miscellaneous operations.

19. The "per cent total operating expenses to total operating revenue" for the income year 1921 was as follows:

(a) For the steam division located partly in North Carolina and partly in Virginia.....	84.51%
15	
(b) For its electric division located wholly in Virginia and doing no business in North Carolina.....	74.37%
(c) For the entire system, including both divisions.....	83.81%

20. Plaintiff attaches hereto a copy of the return made by it to the Commissioner of Revenue for the income year 1921, which is marked Exhibit B, and is prayed to be taken as a part hereof.

21. Plaintiff avers that under the construction which plaintiff is advised the Commissioner of Revenue (who is charged with the duty of construing said law) has, does and will continue to place upon said schedule, plaintiff will be compelled to pay as income tax for the income year 1921 three per cent upon \$653,882.17 or \$19,616.46.

22. During the said income year 1921, plaintiff had gross income arising from sources other than its operations, both railway and miscellaneous, a portion of which arose in North Carolina, as shown upon said return as follows:

From rent of facilities owned by this Company, and which it permitted other companies to use jointly with it	\$11,766.64
Rent from property not used for common carrier business	10,747.19
Receipts from the use of non-operating physical property	8,645.54
Miscellaneous Income	19,719.29
Total	\$50,878.66

16 These items were shown upon said return to the Commissioner of Revenue, in response to the question, What other income plaintiff had, in addition to its operating, both railway and miscellaneous income.

23. During the said income year 1921, plaintiff in addition to its operating expenses, both railway and miscellaneous, uncollectible revenue, taxes and car hire debit balance, had and paid other expenses in connection with its business in North Carolina, as follows:

(1) For the continued use of common carrier facilities owned by other common carriers in North Carolina, and which this plaintiff was permitted to use jointly with the owner for the conduct of, and which was necessary to enable plaintiff to carry on its business as a common carrier, and to which facilities plaintiff was not taking title, and in which it had no equity	\$34,009.76
(2) Rent for the continued use of property other than common carrier property which property was used in plaintiff's business and to which it had not taken, or was not taking title, and in which it had no equity.....	372.83
(3) Rent of leased railroads, located entirely in North Carolina, the payment of which rent was necessary as a condition of the continued use of said roads in its business, and to which roads it was not taking title and in which it had no equity.....	160,365.96
(4) An equal mileage proportion of interest paid on its funded debt.....	778,351.22
(5) An equal mileage proportion of interest paid on its unfunded debt.....	32,587.06
(6) An equal mileage proportion of discount paid on its funded debt.....	21,755.41
(7) Other expenses of conducting and carrying on its business, which under the standard classification of accounting of the Interstate Commerce Commission, are chargeable to income.	50,778.85
Total other expenses.....	\$1,078,221.09

24. That under said Schedule D, all corporations, both domestic and foreign, except those "engaged in the business of operating a steam or electric railroad, express service, telegraph or telephone business, or other form of public service, when such company is required to keep records according to the Standard Classification of Accounting of the Interstate Commerce Commission," would be and are entitled to deduct from their gross income the amounts, if any, paid by such corporations for and on account of the several items and things mentioned and set out in Section 23 of this bill, in order to ascertain their net income, upon the whole or a portion of which according to the rules set out in Section 201 of said schedule, they would be required to pay an income tax.

25. That as plaintiff is advised, the said Schedule D does not permit or authorize the Commissioner of Revenue to deduct the said expenditures, although made during the income year, and were necessary to be made before plaintiff could have any net income to do with as it saw proper, for that plaintiff is a foreign corporation engaged in operating a steam railroad, and is required to keep its records according to the Standard Classification of Accounting of the Interstate Commerce Commission.

18 26. Said Schedule D, for the purpose of ascertaining the deductions which corporations may make from their gross income in order to ascertain their "net income" subject to tax under said schedule, and under the Constitution of the State undertakes to and does classify corporations.

27. Such classification is purely arbitrary, without any real or actual foundation, having no fair or substantial relation to the proper object sought to be accomplished by the legislation, to-wit, the ascertainment and taxation of the net income of domestic corporations and that portion of the net income of foreign corporations derived from business done in the State.

The only bases for such classification are:

(a) Whether they are of that class of corporations commonly known as public service corporations; and if so

(b) How they are required to keep their records.

28. Said Schedule D does not operate equally and uniformly upon all tax payers in similar circumstances; classifies corporations in an unfair, unreasonable and unjust manner in violation of the uniformity clause of the Constitution of the State of North Carolina and of the Fourteenth Amendment to the Constitution of the United States; denies to the plaintiff the equal protection of the laws and deprives the plaintiff of its property without due process of law.

29. That said Schedule D so classifies corporations as to require plaintiff by reason of its being engaged in interstate commerce, 19 to bear an undue and unjust burden, which does not apply to other corporations, when not engaged in interstate commerce, and directly burdens interstate commerce in violation of the commerce clause of the Constitution of the United States.

30. Said Schedule D imposes heavy penalties upon complainant and other tax payers for failing to make returns as required and/or for failing to pay taxes which are or may be assessed and under the laws of North Carolina any taxes imposed or assessed against plaintiff under said Schedule D constitute a first lien upon plaintiff's property, displacing all other liens and constitute a cloud upon the title of plaintiff to its property.

31. Under Section 7979 of the Consolidated Statutes of the State, wherever a tax levied against a tax payer, or any part of such tax is

illegal or invalid, or is levied for an illegal or unauthorized purpose, a court of equity is authorized to enjoin the collection of such tax, and an injunction may under the laws of the State be issued pendente lite to test the validity of such a tax.

32. This plaintiff is entitled in equity to have the cloud cast upon the title to its property by reason of said illegal tax removed; is entitled to have the collection of said tax enjoined, pending the hearing as to its validity, and is entitled to test the validity of said tax, without being inflicted with heavy and burdensome penalties.

20 33. Plaintiff does not concede that any part of said tax is due and has not therefore tendered any tax.

Whereas, and for as much as complainant is remediless in the premises, according to the common law, and remediable only in equity, and that complainant may not be subjected to the pains and penalties set out in the statutes of North Carolina, and that the cloud may be removed from the title to its said properties, and that complainant may not suffer irreparable damage and that its business of an interstate carrier may not be interfered with or unduly burdened, and that it may not be deprived of its property without due process of law, nor denied the equal protection of the laws, and that the correct amount, if any, of taxes which complainant shall be required to pay to State of North Carolina under said Schedule D of Chapter 34 P. L. 1921 may be ascertained, complainant prays for a writ of subpoena to issue against the defendants commanding them to appear and full and true answer make to this bill of complaint and the several things and matters herein set out, but not under oath, an answer under oath being expressly waived.

That the said defendants in their individual and official capacity be enjoined and restrained from taking any steps to collect said taxes levied and imposed under said Schedule D, or to inflict upon complainant any of the pains or penalties authorized to be imposed under or inflicted by the laws of North Carolina, and that a preliminary injunction be issued pending final hearing and upon final hearing the Commissioner of Revenue be enjoined and commanded to cancel the illegal assessment of said taxes and that the said tax so imposed be declared to be illegal and void and the Commissioner of Revenue and the Attorney General, and their successors in office be perpetually enjoined and restrained from taking any steps to collect said illegal taxes, and from selling plaintiff's property or for the collection or imposing of any fines or penalties for failure to pay said taxes, and for all other, further, general and special relief as in equity it may be entitled to.

21

This is the first application for an injunction in this cause.

JOHN M. ROBINSON,
W. B. RODMAN, JR.,
Solicitors for Complainant.

W. B. RODMAN,
C. M. BAIN,
Of Counsel.

STATE OF VIRGINIA,
City of Norfolk:

M. S. Hawkins, being duly sworn, deposes and says that complainant, Norfolk Southern Railroad Company, is a corporation, and that he is one of its officers, to-wit: Secretary; that he has read the foregoing bill of complaint and knows the contents thereof, and that the same is true to his own knowledge, except as to those matters therein stated upon information and belief and as to those he believes it to be true.

M. S. HAWKINS.

Sworn and subscribed to before me this 12th day of April, 1923.

J. R. PRITCHARD,

Notary Public.

My commission expires on the tenth day of January, 1925.

22

EXHIBIT A.

Sections 301 to 307, Inclusive, Revenue Act.

Sec. 301. Gross Income Defined.—1. The words "gross income" include gains, profits and income derived from salaries, wages or compensation for personal service of whatever kind and in whatever form paid, or from professions, vocations, trades, business, commerce or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from interest, rent dividends, securities, or the transactions of any business carried on for gain or profit, or gains or profits and income derived from any source whatever. The amount of all such items shall be included in the gross income of the income year in which received by the taxpayer, unless, under the methods of accounting permitted under this act, any such amounts are to be properly accounted for as of a different period.

2. The words "gross income" do not include the following items which shall be exempt from taxation under this act.

(a) The proceeds of life insurance policies and contracts paid upon the death of the insured to individual beneficiaries or to the estate of the insured.

(b) The amount received by the insured as a return of premium or premiums paid by him under life insurance, endowment or annuity contracts, either during the term or at the maturity of the term mentioned in the contract or upon surrender of the contract.

23 (c) The value of property acquired by gift, bequest, devise or descent (but the income from such property shall be included in gross income).

(d) Interest upon the obligations of the United States or its possessions, or of the State of North Carolina.

(e) Salaries, wages, or other compensation received from the United States by officials or employees thereof, including persons in the military or naval forces of the United States.

(f) Any amounts received through accident or health insurance or under workmen's compensation acts, as compensation for personal injuries or sickness, plus the amount of any damages received, whether by suit or agreement, on account of such injuries or sickness.

Sec. 302. Basis of Return of Net Income.—1. Tax payers who customarily estimate their income on a basis other than that of actual cash receipts and disbursements may, with the approval of the Tax Commission, return their net income under this act upon a similar basis. Taxpayers who customarily estimate their income on the basis of an established fiscal year instead of on that of the calendar year, may, with the approval of the Tax Commission, and subject to such rules and regulations as it may establish, return their net income under this act on the basis of such fiscal year in lieu of that of the calendar year.

2. A taxpayer may, with the approval of the Tax Commission and under such regulations as it may prescribe, change the income year from fiscal year to calendar year or otherwise, in which case his net income shall be computed upon the basis of such new income year.

3. An individual carrying on business in partnership shall be liable for income tax only in his individual capacity, and shall include in his gross income the distributive share of the net income of the partnership received by him or distributed to him during the income year.

4. Every individual taxable under this act who is a beneficiary of an estate or trust, shall include in his gross income the distributive share of the net income of the estate or trust, received by him or distributable to him during the income year. Unless otherwise provided in the law, the will, the deed, or other instrument creating the estate, trust or fiduciary relation, the net income shall be deemed to be distributed or distributable to the beneficiaries (including the fiduciary as a beneficiary, in the case of the income accumulated for future distribution), ratably, in proportion to their respective interests.

Sec. 303. Determination of Gain or Loss.—For the purpose of ascertaining the gain or loss from the sale or other disposition of property, real, personal or mixed, the basis shall be, in the case of property acquired before January 1, 1921, the fair market price or value of such property as of that date, if such price or value exceeds the original cost, and in all other cases, the cost thereof: Provided, that in the case of property which was included in the last preceding annual inventory used in determining net income in a return under this act, such inventory value shall be taken in

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lieu of the cost or market value. The final distribution to the taxpayer of the assets of a corporation shall be created as a sale of the stock or securities of the corporation owned by him and the gain or loss shall be computed accordingly. If at any time gains and profits realized by sale of property by other than traders in such property at an increase over the purchase price, or an increase over the fair value of the property on January 1, 1921, shall be held by the Supreme Court of the United States not to be taxable income by the United States Government, such decision shall govern the liability of such gains and profits for taxation as income under this act.

Sec. 304. Exchanges of Property.—1. When property is exchanged for other property, the property received in exchange shall, for the purpose of determining gain or loss, be treated as the equivalent of cash to the amount of its fair market value: Provided, a market exists in which all the property so received can be disposed of at the time of exchange, for a reasonably certain and definite price in cash; otherwise such exchange shall be considered as a conversion of assets from one form to another, from which no gain or loss shall be deemed to arise.

2. In the case of the organization of a corporation, the stock or securities received shall be considered to take the place of property transferred therefor and no gain or loss shall be deemed to arise therefrom.

26 3. When, in connection with the reorganization, merger, or consolidation of a corporation, a tax payer received, in place of stock or securities owned by him, new stock or securities, the basis of computing the gain or loss, if any shall be, in case the stock or securities owned were acquired before January 1, 1921, the fair market price or value thereof as to that date, if such price or value exceeds the original cost, and in all other cases the cost thereof.

Sec. 305. Inventory.—Whenever in the opinion of the Tax Commission the use of inventories is necessary in order clearly to determine the income of any taxpayer, inventories shall be taken by such tax payer, upon such basis as the Tax Commission may prescribe, conforming as nearly as may be to the best accounting practice in the trade or business and most clearly reflecting the income, and conforming so far as may be to the forms and methods prescribed by the United States Commissioner of Internal Revenue, under the act of Congress than providing for the taxation of income.

Sec. 306. Deductions.—In computing net income there shall be allowed as deductions:

1. All the ordinary and necessary expenses paid during the income year in carrying on any trade or business, including:

(a) As to individuals, wages of employees for services actually rendered in producing such income.

(b) As to partnerships, wages of employees and a reasonable allowance for copartners or members of a firm, for services actually rendered in producing such income, the amount of such salary allowance to be included in the personal return of the copartner receiving same.

(c) As to corporations, wages of employees and salaries of officers, if reasonable in amount, for services actually rendered in producing such income.

2. Rentals or other payments required to be made as a condition of the continued use or possession, for the purposes of the trade of property to which the taxpayer has not taken or is not taking title or in which he has no equity.

3. All interest paid during the income year on indebtedness except interest on obligations contracted for the purchase of non-taxable securities. Dividends on preferred stock shall not be deducted as interest.

4. Taxes for the income year, except taxes on income and war profits, and excess profits taxes, inheritance taxes, and taxes assessed for local benefit of a kind tending to increase the value of the property assessed.

5. Dividends from stock in any corporation the income of which shall have been assessed and the tax on such income paid by the corporation under the provisions of this act: Provided, that when only part of the income of any corporation shall have been assessed under this act only a corresponding part of the dividends received therefrom shall be deducted.

6. Losses sustained during the income year and not compensated for by insurance or otherwise, if incurred in any transaction entered into for profit.

7. Debts ascertained to be worthless and charged off within the income year, if the amount has previously been included in gross income in a return under this act.

8. A reasonable allowance for the depreciation and obsolescence of property used in the trade or business; and, in the case of mines, oil and gas wells, other natural deposits, and timber, a reasonable allowance for depletion: Provided, that in computing the deductions allowed under this paragraph, the basis shall be the cost (including in the case of mines, oil, and gas wells, and other natural deposits, the cost of development, not otherwise deducted), and in the case of property acquired prior to January 1, 1921, the fair market value of the property (or the tax payer's interest therein) on that date shall be taken in lieu of cost up to that date. The reasonable allowances under this paragraph shall be made under rules and regulations to be prescribed by the Tax Commission. In the case of leases the deductions allowed may be equitably apportioned between the lessor and lessee.

9. In the case of taxpayers who keep regular books of account, upon an accrual basis and in accordance with standard accounting practice, reserves for bad debts and for contingent liabilities, under such rules and restrictions as the Tax Commission may impose. If the Tax Commission shall at any time deem the reserve excessive in amount it may restore such excess to income, either in a subsequent year or as a part of the income of the income year and assess it accordingly.

10. Contributions or gifts made within the taxable year to corporations or associations operated exclusively for religious, charitable, scientific or educational purposes or for the prevention of cruelty to children or animals, no part of the net earnings of which inures to the benefit of any private stockholder or individual, to an amount not in excess of fifteen per centum of the taxpayer's net income as computed without the benefit of this subdivision.

11. Resident individuals having an established business in another State, or investment in property in another State, may deduct the net income from such business or investment, if such business or investment is in a State that levies a tax upon such net income. The deduction authorized in this subsection shall in no case extend to any part of income of resident individuals from personal services, or mortgages, stocks, bonds, securities and deposits.

12. In the case of a nonresident individual, the deductions allowed in this section shall be allowed only if, and to the extent that, they are connected with income arising from sources within the State; and the proper apportionment and allocation of the deductions with respect to sources of income within and without the State shall be determined under rules and regulations prescribed by the State Tax Commission.

Sec. 307. Items Not Deductible.—In computing net income no deduction shall in any case be allowed in respect of:

(a) Personal, living or family expenses.

(b) Any amount paid out for new buildings or for permanent improvements or betterments, made to increase the value of any property or estate.

(c) Any amount expended in restoring property for which an allowance is or has been made.

(d) Premiums paid on any life insurance policy.

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EXHIBIT B.

State Department of Revenue.

Public Service Corporation Income Tax Return.

(Railroads.)

For Calendar Year Ending December 31, 1921.

Norfolk Southern Railroad Company, Union Station, East Main St.,
Norfolk, Virginia.

We, the undersigned, president and treasurer of the corporation for which this return is made, being severally duly sworn, each for himself deposes and says that this return, including the accompanying schedules and statements, has been examined by him and is, to the best of his knowledge and belief, a true and complete return made in good faith, for the taxable period as stated, pursuant to the Revenue Act for 1921 and the Regulations issued under authority thereof.

G. R. LOYALL,
President.

J. F. GEORGE,
Treasurer.

Sworn to and subscribed before me, this 10th day of April, 1922.

J. R. PRITCHARD,
Notary Public.

My commission expires January 10, 1925.

*Net operating income (when business is wholly within the State).....	\$.....
*Net operating revenue, including equal mileage proportion within this State of the interstate business (when business is in part within and in part without the State).....
Other income.....
See schedule attached as a part hereof.	
Total income.....	\$.....
*Operating expenses (when business is wholly within the State).....
31 *Proportionate average of operating expenses (when business is in part within and in part without the State).....	\$.....
*Uncollectible revenue.....
Taxes paid in this State, other than income and war profits and excess profits taxes.....
Total deductions.....	\$.....
Operating income, less deductions.....	\$.....

*As per standard Classification of Accounts of Interstate Commerce Commission.

Plus or Minus any credit or debit balance received or paid on account of car hire. And when any railroad is partly within and partly without the State then said net operating income shall be increased or decreased to the extent of an equal mileage proportion within this State of any credit or debit balance received or paid.....

\$.....

Net taxable income.....

\$.....

Tax @ 3%.....

\$.....

Main track mileage (system) Steam Div.....

900.38

Main track mileage (State) Steam Div.....

829.64

Main track mileage Electric Division Wholly within Virginia..

42.30

Railroads and Public-service Corporations; Basis of Ascertaining Net Income.—The basis of ascertaining the net income of every corporation engaged in the business of operating a steam or electric railroad, express service, telephone or telegraph business, or other form of public service, when such company is required to keep records according to the standard classification of accounting of the Interstate Commerce Commission, shall be the “net operating income” of

32 such corporations as shown by their records kept in accordance with that standard classification of accounts, when their business is wholly within this State, and when their business is in part within and in part without the State their net income within this State shall be ascertained by taking their gross “operating revenues” within this State, including in their gross “operating revenues” within this State the equal mileage proportion within this State of their interstate business and deducting from their gross “operating revenues” the proportionate average of “operating expenses,” or “operating ratio,” for their whole business, as shown by the Interstate Commerce Commission standard classification of accounts. From the net operating income thus ascertained shall be deducted “uncollectible revenue,” and taxes paid in this State for the income year, other than income taxes and war profits and excess profits taxes, and the balance shall be deemed to be their net income taxable under this act.

Car Hire Considered.—In determining the taxable income of a corporation engaged in the business of operating a railroad under the preceding section, in the case of a railroad located entirely within this State, the net operating income shall be increased or decreased to the extent of any credit or debit balance received or paid, as the case may be, on account of car hire; and when any railroad is located partly within and partly without this State, then said net operating income shall be increased or decreased to the extent of an equal mileage proportion within this State of any credit or debit balance received or paid, as the case may be, on account of car hire.

33 *Schedule Attached to and Forming Part of Return of the Norfolk Southern Railroad Company.*

Norfolk Southern Railroad Company, a corporation organized and existing under the laws of the State of Virginia, owning and operating a line of railroad located partly within and partly without the State

of North Carolina, and as common carrier by railroad engaged in interstate commerce, protesting that it is not by law required to make a return to the Commissioner of Revenue for the State of North Carolina of its income for the year 1921, under protest and to avoid penalties, makes the following statement as to its income for the year 1921, from its steam division located partly within and partly without the State, excluding its income from its electric division, which is located entirely within the State of Virginia, where no part of its business is done in North Carolina, and attaches this schedule to the return, which return is made under protest.

Gross Railway Operating Revenue derived from intrastate business in North Carolina, including an equal mileage proportion of the interstate business when partly within and partly without the State of North Carolina	\$6,929,298.03	
Proportionate average of Railway Operating Expenses of line located partly within and partly without the State, where business is done either within or partly within and partly without the State of North Carolina	5,855,949.82	
Balance of Gross Railway Operating Revenue as above, after deducting proportionate average of Railway Operating Expenses as above	\$1,073,348.21	
Miscellaneous operations entirely within the State of North Carolina (Loss)	24,474.17	
34 Net amount received from operations both Railway and Miscellaneous as above	\$1,048,874.04	
Equal mileage proportion of uncollectible railway revenue	\$313.10	
Taxes, except income, excess profit and war taxes	314,838.62	
Equal mileage proportion of car hire debit balance	130,718.81	
		445,870.53
Balance of gross income from operations (both railway and miscellaneous) after deductions as above ..	\$603,003.51	

Other income and expenses, any part of which is derived from sources within North Carolina, excluding dividends from corporations organized under the laws of North Carolina, which corporations pay an income tax to the State of North Carolina, upon their entire net income:

Rent from facilities owned by this company and used jointly by other railroads, joint facility rent	\$11,766.64	
Miscellaneous Rent income	10,747.19	
Miscellaneous Non-operating physical property	8,645.54	
Miscellaneous income	19,719.29	
Total		50,878.66
		<u>\$653,882.17</u>

Expenses Incurred in the Conduct of its Business in North Carolina, other than Expense of Operation, both Railway and Miscellaneous:

Joint Facility Rent (Rent paid for use of facilities of other carriers)	\$34,009.76	
Miscellaneous rent	372.83	
Rent of leased railroad, located entirely in North Carolina, the payment of which rent was necessary as a condition for the continued use of said roads in the conduct of its business	160,365.96	
Equal Mileage proportion of interest on Funded debt	778,351.22	
Equal Mileage proportion of interest on unfunded debt	32,587.06	
Discount on funded debt	21,755.41	
Miscellaneous expenses chargeable to income	50,778.85	
		<u>1,078,221.06</u>
Deficit		<u>\$424,338.92</u>

Application for Interlocutory Injunction.

Filed April 22, 1922.

In the District Court of the United States for the Eastern District of
North Carolina.

In Equity.

No. 450.

NORFOLK SOUTHERN RAILROAD COMPANY

vs.

A. D. WATTS, Commissioner of Revenue for North Carolina, and
JAMES S. MANNING, Attorney General for North Carolina.

Comes the above named plaintiff and shows the court:

That it has instituted in this Court by bill of complaint an action against A. D. Watts, as Commissioner of Revenue of the State of North Carolina, and James S. Manning, as Attorney General for the State of North Carolina, as shown in said bill which is now referred to and made a part of this application, the object and purpose of the action being to secure from this Honorable Court an order enjoining preliminarily and perpetually the defendants, who are tax assessing, collecting, and enforcing officers of the State of North Carolina for the assessment and collection of an income tax sought to be imposed under Schedule D, Chapter 34 of the Public Laws of 1921, commonly known as the Revenue Act of the State of North Carolina.

The bill alleges and sets forth that the said statute is illegal and invalid and that no tax can be assessed against or collected from plaintiff, and further sets forth the grounds of the unconstitutionality of the assessment and of the said statutes of North Carolina, under which the said invalid assessment is made, and under which the taxes alleged to be illegal will be collected by the defendants named in said bill unless restrained by this Honorable Court, all of which is more fully alleged, set out and explained in the bill of complaint filed therein.

Wherefore, application is made under Section 266 of the Judicial Code for an interlocutory injunction as prayed for in said bill, and this Court is petitioned to call to his assistance to hear and determine this application two other judges, and that the statutory notice of the hearing of this application be given the Governor and the Attorney General of the State of North Carolina and each of the defendants to the said bill, and an order issue requiring the defendants to show cause at the time and place to be fixed by this Court according to law why said interlocutory injunction should not issue as prayed for.

This application is based upon the verified bill of complaint on file herein.

W. B. RODMAN,
Attorney for Plaintiff.

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Equity Subpœna.

UNITED STATES OF AMERICA,
Eastern District of North Carolina:

District Court at Raleigh, Fourth Circuit.

The United States of America to A. D. Watts, Commissioner of Revenue, Raleigh, N. C.; James S. Manning, Attorney General, Raleigh, N. C., Greeting:

We command you, and every of you, that you appear before the Judges of our District Court of the United States of America, for the Eastern District of North Carolina, at the office of the Clerk of said Court, in the City of Raleigh, in said District, on the 5th day of May next, to answer the Bill of Complaint of Norfolk Southern Railroad Company, citizen and resident of the State of Virginia, filed in the Clerk's office of said Court, in said City of Raleigh, then and there to receive and abide by such judgment and decree as shall then or thereafter be made, upon pain of Judgment being pronounced against you by default.

To the Marshall of the eastern district of North Carolina to execute.

Witness, The Hon. William Howard Taft, Chief Justice of the Supreme Court of the United States, at Raleigh, in said District, the 15 day of April, 1922, and in the 146 year of the Independence of the United States.

Issued the 15 day of April, 1922.

[Seal of the Court.]

S. A. ASHE,
Clerk U. S. District Court.

The within-named defendants are notified that unless they enter their appearance in the Clerk's office of said District Court at Raleigh and file their answer, or other defense, on or before the 20th day after service hereof, excluding the day of service, the bill filed herein will be taken as confessed and a decree entered accordingly.

S. A. ASHE,
Clerk U. S. District Court.

[Endorsed:] No. 450. Equity. In United States District Court, Eastern District of North Carolina, at Raleigh. Norfolk Southern Railroad Co. against A. D. Watts et al. Equity subpœna. Returnable the 5th day in May, 1922. Duplicate original for — — — — —, Solicitors for Complainants.

Marshal's Return on Subpœna.

Filed April 18, 1922.

Received at Raleigh, N. C., April 18, 1922 and executed at Raleigh, N. C., April 18, 1922 by delivering copy to A. D. Watts and J. S. Manning.

R. W. WARD,
U. S. Marshal,
By C. H. HUNNICUTT,
Deputy U. S. Marshal.

Marshal's fees \$4.00.

Extract from the Minutes of the Court, April 15, 1922.

In the District Court of the United States for the Eastern District of North Carolina.

In Equity.

No. 450.

NORFOLK SOUTHERN RAILROAD COMPANY

vs.

A. D. WATTS et al.

Present: The Honorable Henry G. Conner, Judge of the District Court for the Eastern District of North Carolina.

Order.

"It is ordered that this cause be set down for final hearing on its merits on Monday, June 13, 1922, Counsel for Plaintiff and Defendants being in open Court and assenting thereto; application for Interlocutory Injunction being waived by Counsel for Plaintiff."

Answer.

Filed May 5th, 1922.

In the District Court of the United States for the Eastern District of
North Carolina.

In Equity.

No. —.

NORFOLK SOUTHERN RAILROAD COMPANY, Complainant,

v.

A. D. WATTS, Commissioner of Revenue, and JAMES S. MANNING,
Attorney-General of the State of North Carolina, Defendants.

Answer.

To the Honorable H. G. Connor, Judge of the District Court of the
United States for the Eastern District of North Carolina:

The defendants above named, answering the bill herein, respectfully show the Court that:

1. Article I of the bill is admitted.
2. Article II of the bill is admitted.

3. It is admitted that the amount in controversy in this case, exclusive of interest and cost, exceeds the sum of \$3,000. The remainder of Article III of the bill is denied, not being true as stated. Defendants allege that complainant has no valid right to resort to a court of equity, inasmuch as it has an adequate remedy at law in Section 7979 of the Consolidated Statutes of the State of North Carolina and in an act of the Extra Session of 1921, entitled "An act to refund taxes illegally collected and paid into the State treasury."

4. Article IV of the bill is admitted.

- 41 5. Article V of the bill is admitted.

6. Article VI of the bill is admitted.

7. Article VII of the bill is admitted. Said companies, however, are required to pay income tax under other sections of the Income Tax Act of 1921.

8. Article VIII of the bill is admitted.

9. Article IX of the bill is admitted.

10. Article X of the bill is admitted, except as to its first clause, which, having been amended at the Extra Session 1921, should read as follows:

"Sec. 201. Corporations.—Every corporation organized under the laws of this State shall pay annually an income tax equivalent to 3 per cent of the entire net income of such corporation, as herein defined, received by such corporation during the income year; and every foreign corporation doing business in this State shall pay annually an income tax equivalent to 3 per cent of a proportion of its entire net income, to be determined according to the following rules:"

11. Article XI of the bill is admitted.

12. Article XII of the bill is admitted.

13. Article XIII of the bill is admitted, except it is denied that the State of North Carolina levies any income tax upon the net income derived from the business of importing from, or exporting to, any foreign country.

14. Article XIV of the bill is not true as stated, and so is denied. If there are any such corporations, they will pay income tax under the other provisions of the Income Tax Act of 1921.

15. Article XV of the bill is not true as stated, and so is denied. Further answering said article, defendants aver that the Atlantic and North Carolina Railroad Company, Durham and South Carolina Railroad Company, and Carthage and Pinehurst Railroad Company, the lessors of the complainant, are not railroad corporations coming within the classification of Section 202 of the Income Tax Act of 1921, but are subject to the other provisions of said act, and, as such, have to pay 3 per cent income tax on their net income for the year 1921; that the complainants' obligation to pay this income tax arises from the express provision of its contract of lease, and so, when it pays it, it pays it in behalf of these companies and not as an obligation imposed upon it by the Income Tax Law of 1921. The income-tax provision of the Constitution of the State of North Carolina, quoted in Article IX of the bill, authorizes the Legislature to determine what shall be the net income to be taxed thereunder, and expressly prohibits the allowing of any deduction for living expenses. The statute enacted by the General Assembly of 1921 in pursuance of such constitutional authority (Chapters 34 and 35 of the Public Laws of 1921), classifies income-tax payers as follows, providing for each class a different method for ascertaining taxable incomes: first, resident individuals; second, nonresident individuals (Section 200); third, resident corporations; fourth, nonresident corporations (Section 201); fifth, railroads and other public-service corporations having their lines wholly within the State; and sixth, railroads and other public-service corporations having their lines partly within the State and partly without; and the defendants are advised, and so aver, that such classification does not in any way offend against any provision of the State or Federal Constitution. No one of these classes is allowed the same deduction or exemption as those allowed to the other classes, and in each case the distinctions

made are made on account of an inherent difference between the classes themselves. The statute itself (Section 202) provides the method by which the net income of railroads is to be ascertained. It declares that, as to such railroads operating wholly in the State, the net income shall be "the net operating income" as shown by their records, kept in accordance with the standard classification of accounts of the Interstate Commerce Commission. As to railroads, when their business is part within and part without the State, it declares their net income within the State shall be ascertained by taking their gross "operating revenues" within this State, including

43 in their gross "operating revenues" within this State the equal mileage proportion within this State of their interstate business and deducting from their gross "operating revenues" the proportionate average of "operating expenses," or "operating ratio," for their whole business, as shown by the Interstate Commerce Commission standard classification of accounts. From the sum so found, they are allowed to deduct "uncollectible revenues" and taxes paid in this State for the income year, other than income taxes and war profits and excess profits taxes, etc., and the balance shall be deemed to be their net income taxable under this act. The method thus provided by the General Assembly for ascertaining the net income of such railroads, as defendants are advised and aver, is both legally and constitutionally a proper one to apply to them, and does not offend against the interstate commerce clause of the Federal Constitution; that deductions and exemptions are allowed individuals which are not allowed ordinary corporations or railroads, and that deductions are allowed ordinary corporations which are not allowed railroads, in specific terms, arises from the necessity to classify income-tax payers, so as to arrive at their net income, and that necessity arises from differences inherent in the various businesses thus classified. Without such classification, defendants are advised and believe, it would be impossible to levy a fair and just income tax. Defendants are advised and believe that, in applying the method provided in the act, many deductions are necessarily allowed, besides those specifically set out in Section 202, "uncollectible revenue," and taxes paid in this State for the income year, etc., i. e., wages of employees, salaries of officers, if reasonable in amount, for services actually rendered in producing such income, and others too numerous to incorporate in this answer. A list of them is hereto attached, marked "Exhibit A," and is asked to be taken as part of this answer.

16. Having fully answered Article XVI of the bill in Article XV. of this answer, the same is here referred to.

44 17. Article XVII of the bill is admitted. Further answering this article, it is admitted that interest paid during the tax year on outstanding bonded and other indebtedness is not one of the deductions allowed to railroads, whereas it is allowed to individuals and business corporations, but many other deductions are allowed to railroads which are not allowed to either individuals and business corporations. See Exhibit A. Defendants are informed

and believe, and so aver, that the method of financing railroads is so wholly different from that of other corporations that they are necessarily in a class to themselves with other public-service corporations, and that a refusal, under such circumstances, to permit a deduction for interest on their bonded indebtedness is justified and is not a discrimination against them. The statute (Section 306, subsection 3) expressly prohibits the deduction of dividends on preferred stock to business corporations. The process of arriving at the net income earned by railroad having part of their line in the State and part out is necessarily long and intricate. The General Assembly, knowing this, and knowing also that the simplest way of arriving at such a net income was by using as a basis the records required to be kept by the Interstate Commerce Commission, adopted that plan and declared in Section 202 what should be the net income of such corporations in its application to them.

18. Article XVIII of the bill, being an interpretation of the statute (Section 202 of the Income Tax Act), has been fully answered in the answers herein numbered 15 and 17.

19. The defendants have no information sufficient to form a belief as to the truth of allegation XIX of the bill, and so it is denied.

20. Defendants admit that the copy of the return made by complainant of income year 1921 is correctly set forth as Exhibit B of the bill.

21. Article XXI of the bill is admitted.

22. Article XXII of the bill is admitted.

23. Article XXIII of the bill, having been fully answered under allegations XV and XVII of this answer, is not true as stated, and so is denied.

24. Article XXIV of the bill is not true as stated, and so is denied, except as admitted herein under allegations XV and XVII of this answer.

25. Article XXV of the bill is admitted.

26. Article XXVI of the bill is admitted.

27. Article XXVII of the bill is not true as stated, and so is denied. Defendants aver, as set out in the answers of Articles XV and XVII, that the classification of the Income Tax Act of 1921 is both legal and constitutional.

28. Article XXVIII of the bill is not true as stated, and so is denied.

29. Article XXIX of the bill is not true as stated, and so is denied.

30. Article XXX of the bill is not true as stated, and so is denied. Defendants expressly deny that the penalties set forth in Section 600 of the Income Tax Act are excessive, unreasonable, oppressive,

and inequitable. Those penalties are imposed for wilful or fraudulent failure to comply with the provisions of the act, and so would not be a denial of due process of law to the complainant. The Revenue Commissioner and the Attorney-General are given authority to waive or reduce the penalties therein provided for.

31. In answer to Article XXXI of the bill, defendants aver that complainant has a complete and adequate remedy at law to recover back any illegal tax paid into the treasury of the State. Under Section 504 of the Income Tax Act, the Commissioner of Revenue may issue an order, under his hand and official seal, directed to the sheriff of any county in the State, commanding him to levy upon and sell the real and personal property of the taxpayer. The payment of such tax, however, will prevent any sale, and the taxpayer is given an adequate remedy at law, under Section 7979 of the Consolidated Statutes of 1919 and in an act of the Extra Session,

46 1921, entitled "An act to refund taxes illegally collected and paid into the State treasury."

32. Article XXXII of the bill is not true as stated, and so is denied.

Wherefore, having fully answered, the defendants pray judgment:

1. That the bill be dismissed.
2. For the cost of the action.
3. For such other and further relief as to the Court may seem just.

JAMES S. MANNING,

Attorney-General of North Carolina,

FRANK NASH,

Assistant Attorney-General of North Carolina,

Solicitors for Defendants.

GEO. H. BROWN,

WM. P. BYNUM,

LOCKE CRAIG,

THOS. D. WARREN,

S. S. ALDERMAN,

Of Counsel.

NORTH CAROLINA,
Wake County:

A. D. Watts, being duly sworn, says that he is Commissioner of Revenue of the State of North Carolina and one of the defendants in the above entitled action; that he knows the contents of the foregoing answer, and it is true, of his own knowledge, except as to matters therein stated on information and belief, and as to those he believes it to be true.

A. D. WATTS.

Sworn and subscribed before me, this May 4, 1922.

EDWARD C. SEAWELL,
Deputy Supreme Court Clerk.

EXHIBIT "A" TO ANSWER.

I. Maintenance of Way and Structures:

Superintendence, roadway maintenance—other; bridges, trestles, and culverts—other; ties—other; rails—other; other track material—other; ballast—other; track laying and surfacing—other; right of way fences—other; crossings and signs—other; station and office buildings; roadway buildings; water stations; fuel stations; shops and engine houses; wharves and docks; telegraph and telephone lines; signals and interlockers; power substation buildings; power transmission systems; power distribution systems; power line poles and fixtures; paving; roadway machines; small tools and supplies; removing snow, ice, and sand; injuries to persons; stationery and printing; other expenses; maintaining joint tracks, yards, and other facilities—Dr.; maintaining joint tracks, yards, and other facilities—Cr.

II. Maintenance of Equipment:

Superintendence; shop machinery; power plant machinery; power substation apparatus; steam locomotives—repairs; steam locomotives—depreciation; other locomotives—repairs; other locomotives—depreciation; freight-train cars—repairs; freight-train cars—depreciation; freight-train cars—retirements; passenger-train cars—repairs; passenger-train cars—depreciation; passenger-train cars—retirements; motor equipment of cars—repairs; motor equipment of cars—depreciation; floating equipment—repairs; floating equipment—depreciation; work equipment—repairs; work equipment—depreciation; injuries to persons; insurance; stationery and printing; other expenses; maintaining joint equipment at terminals—Dr.

III. Traffic:

Superintendence; other agencies; advertising; traffic associations; stationery and printing; other expenses.

IV. Transportation—Rail Line:

Superintendence; dispatching trains; station employees; weighing, inspection, and demurrage bureau; station supplies and expenses; yardmasters and yard clerks; yard conductors and brakemen; yard switch and signal tenders; yard enginemen; yard motormen; fuel for yard locomotives; water for yard locomotives; lubricants for yard locomotives; other supplies for yard locomotives; engine-house expenses—yard; yard supplies and expenses; train enginemen; train motormen; fuel for train locomotives; train power produced; water for train locomotives; lubricants for train locomotives; other supplies for train locomotives; engine-house expenses—train; trainmen; train supplies and expenses; signal and interlocker

operation; crossing protection; drawbridge operation; telegraph and telephone operation; operating floating equipment; stationery and printing; other expenses; insurance; clearing wrecks; damage to property; damage to livestock on right of way; loss and damage—freight; loss and damage—baggage; injuries to persons; operating joint yards and terminals—Dr.; operating joint yards and terminals—Cr.; operating joint tracks and facilities—Dr.; operating joint tracks and facilities—Cr.

VI. Miscellaneous Operations:

Producing power sold.

VII. General:

Salaries and expenses of general officers; salaries and expenses of clerks and attendants; general office supplies and expenses; law expenses; insurance; pensions; stationery and printing; valuation expenses; other expenses; general joint facilities—Dr.

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Affidvit of A. J. Maxwell

Filed June 5, 1922.

In the District Court of the United States for the Eastern District of North Carolina.

In Equity.

SOUTHERN RAILWAY CO. et als., Plaintiffs,

v.

A. D. WATTS and A. D. WATTS, as Commissioner of Revenue, et als.,
Defendants.

Railroad Income Tax Suits.

Affidavit of A. J. Maxwell.

A. J. Maxwell, being first duly sworn, deposes and says:

Affiant is a member of the State Corporation Commission of North Carolina and has been such since 1910, during which time the said commission was, until 1921, also the State Tax Commission with the duties and functions with reference to administering the tax laws of the State imposed upon the newly created State Department of Revenue by the statute of 1921. In such position the affiant has been directly connected in an official capacity with the administration of the tax laws of the State until the creation of the State Department of Revenue to replace the State Tax Commission as such. In such capacity the affiant was in constant consultation with the finance committees of the General Assembly at the time of the drafting of the Income Tax Act of 1921. In such capacity the

affiant has had extensive experience familiarizing him with the Standard Classification of Accounts of the Interstate Commerce Commission, has made a special and comparative study of the taxation systems of other states and of the subject of taxation.

When the enactment of the Income Tax Act of 1921 was under consideration in the finance committees of the General Assembly, the railroads were heard on the matter and they made the same objection to the provisions of Section 202 that they are now making in these suits. They argued that the application of those provisions to them would not lead to an ascertainment of their net income because certain items, notably interest on bonded indebtedness and rentals paid for leased properties, were not included in the operating expenses in the said Standard Classification, whereas as to individuals and to corporations other than public service corporations deductions were allowed under general terms of the Act which the railroads alleged to be analogous to such interest and rentals.

The legislative committees considered these objections fully and carefully. In enacting the Act in the terms, finally adopted, the General Assembly considered certain well known facts with reference to the method in which railroad corporations are financed. It is a general rule that railroads are financed almost entirely by bond issues, their stock being issued largely incidentally and sometimes even distributed as bonus with the bonds. The rule is that the capital finances are procured by bond issues. This being the case, interest paid on the bonds is properly considered not as a current, operating, or business expense, but as a capital expense. The legislature considered that "net income" as generally understood and as judicially defined means the business revenues less all those expenses incurred in the earning of such revenues, but not deducting any expense on account of or to provide for capital or permanent investment in the business. It was manifest, therefore, that if interest on bonds should be allowed as a deduction in arriving at net income of railroads, this would be the allowing of a capital expense not an operating or business expense, and the result obtained after making such deduction in addition to operating and business expenses would not be the net income of the railroad but less.

With reference to the matters of rentals paid for the lines leased and operated by the railroads, the committees considered the well-known facts that these leases are usually for long terms and with numerous collateral obligations which made them amount practically to purchases of the lessor road's properties by the lessee, and that, this being true, the consideration paid for such long leases of property used fully as if the property of the lessee in its business is really not an operating expense but is by clear analogy and in practical effect a capital expense. If these expenses were allowed as deductions to the plaintiffs, the result would be that they would have no income subject to tax until they had earned enough to provide, not only for all business and operating expenses, but also for all capital expenses and had paid all interest on their bonds; in other words, it would amount to nothing more than a tax on the savings of railroads, which would render the tax utterly incom-

mensurate with that imposed as income tax on individuals and other ordinary corporations.

Affiant states it as his opinion that the Income Tax Act as applied to railroads and other public service corporations under the provisions of Sec. 202 results in a strictly fair and just tax upon their net income, entirely commensurate in scope and burden with the tax imposed on other corporations, and individuals, except that perhaps, in view of the fact that individuals are allowed no deduction whatever for living and family expenses, which expenses are analogous to many items allowed all corporations as deductions, the tax bears relatively more heavily on individuals than on corporations by reason of the constitutional inhibition against allowing such deductions to individuals.

As to the contention of the plaintiffs that it is arbitrary classification and discrimination to base a classification on the question whether the taxpayer is required to keep his accounts in accordance with the Standard Classification, the affiant is advised and believes, and so states, that so long as all railroads are placed within the class and are treated alike without discrimination, the classification is reasonable and not arbitrary, because the distinction of being railroads and not other corporations is a practical and reasonable basis of distinction and classification. Affiant asserts further that all railroads are taxed alike under the Income Tax Act of 1921. All are required to make return for taxation on Income Tax Blank Form 7, according to the Standard Classification of Accounts; and that the class is even broader than that of railroads, including all other public service corporations, these being required to make return on Form 8, according to the same Standard Classification, as sworn to in the affidavit of O. S. Thompson filed by the defendants herein.

When railroads keep the Standard Classification of Accounts, under Federal or State requirement, the only practical method of requiring return for income tax to be made is according to such classification of accounts, and for the State to require different accounting, or to require return according to another system of accounting, would conflict practically with the power of the Interstate Commerce Commission to prescribe uniform classification of accounts. The State of North Carolina has not undertaken to prescribe any system of accounting for the plaintiffs or other railroads in conflict with that already required to be kept by the Interstate Commerce Commission, but has adopted that system as the best and most practical basis for the calculation of net incomes for taxation.

[SEAL.]

A. J. MAXWELL,
Affiant.

Subscribed and sworn to before me this the 5th day of June, 1922

W. H. PITTMAN,
Notary Public.

My commission expires July 29, 1922.

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Affidavit of R. O. Self.

Filed June 5, 1922.

In the District Court of the United States for the Eastern District
of North Carolina.

In Equity.

SOUTHERN RAILWAY COMPANY et als., Plaintiffs,

vs.

A. D. WATTS and A. D. WATTS, as Commissioner of Revenue, et als.,
Defendants.

Railroad Income Tax Suits.

Affidavit of R. O. Self.

R. O. Self being duly sworn, deposes and says:

Affiant is the clerk of the State Corporation Commission of North Carolina, has been such since the first of September 1919, and as such is the custodian of the records of the said Commission and is thoroughly familiar with the administering by the Commission of its duties and powers given it by statute. He is thoroughly familiar with the classification made by the Corporation Commission of corporations subject to its supervision.

Affiant has read the affidavit of Mr. A. R. Turnbull, President of the Rowland Lumber Company, which affidavit is filed by the Norfolk Southern Railroad Company in these suits, and affiant is familiar with contents thereof. He has also read and is familiar with the contents of the affidavit of Mr. Nathan O'Berry, President of the Enterprise-Whiteville Lumber Company, filed by the said plaintiff in these suits.

The said Rowland Lumber Company, and the said Enterprise-Whiteville Lumber Company do what is known as a limited transportation business, and are authorized by the Commission to carry on their logging roads certain limited commodities other than their own property. These corporations are not railroad Corporations, but are lumbering corporations. Their lines of tramway, or railroad, are constructed by them for the purpose of hauling logs and lumber and operating their lumber business. When such roads are established there are frequent demands by the communities through which they run, for them to transport other commodities for the convenience and accommodation of the inhabitants of those communities. Under Section 3413, Consolidated Statutes, the Corporation Commission has the power to, and in proper cases does, grant authority to such logging or lumber companies to carry for

hire over their logging, or tramway, roads commodities of others within certain limitations.

These corporations are not classed, considered, or treated by the Corporation Commission as railroads, but they are subjected to the supervision of the Commission, chiefly to prevent discrimination as to the very limited carrier service which they are allowed to perform. They are not classed as common carriers, in the same class as railroads such as the plaintiffs in these suits.

As to the Rowland Lumber Company, it entered into the business referred to in the affidavit of Mr. Turnbull not for profit, but purely for the accommodation of the community, as the following quotations from letters and documents will show:

Letter from Mr. A. R. Turnbull, President, Rowland Lumber Company to W. G. Womble, Rate Clerk, State Corporation Commission, Raleigh, N. C., March 22, 1918:

"It is true that we have been handling fertilizer over the west end of our road for the benefit of the people located in that territory. This is merely an accommodation to them, and is of no benefit to us; * * * If these people do not care for this accommodation it will certainly be a great pleasure for us, under present circumstances to discontinue this hauling of freight for them, as it is done absolutely at cost to us on the present basis."

Letter from Stevens & Beasley, Attorneys for the Rowland Lumber Company, to the North Carolina Corporation Commission, dated March 27, 1918. This letter after referring to complaints made by certain citizens of Faison, N. C., against the Rowland Lumber Company for alleged excessive charges for hauling fertilizer, says:

"The Rowland Lumber Company is not operating a logging business, over its road, this year, in Sampson County to any extent but is confining its operations to its log road in Duplin. It has not even determined to open up its road in Sampson County for the carrying of freight as charged, but was simply coming to the rescue of the farmers of Sampson County, and aiding them, as all good citizens should do, in making food for fighting Germany. For all the winter the roads in that section have been almost impassable with an empty vehicle and had the farmers, many of them 15 miles from the railroad, been permitted by the roads to have hauled at all the cost would have been enormous, from \$3 to \$5 per ton and in this emergency the Rowland Lumber Company has been helping them out at great inconvenience to itself and even a loss. Labor conditions are such the cost of operating is so high that no one except a man like Mr. Turnbull would have undertaken to deliver the fertilizer to these people and he regrets that they have been so shortsighted as to kick, for it might have been possible for the road to have been developed into a public carrier under his generous impulses and public spirit. In building the Atlantic & Carolina Railroad, he has done more for Duplin County than any other one man."

The authority granted to the Rowland Lumber Company, as aforesaid, was granted pursuant to petition filed by the Rowland Lumber Company with the Corporation Commission, copy of which is attached hereto and marked Exhibit "A," and which petition shows that it was made purely to accommodate citizens, who requested such service of the Rowland Lumber Company.

On the 27th of February, 1922, Mr. A. R. Turnbull, President of the Rowland Lumber Company, addressed another letter to Mr. W. G. Womble, Rate Clerk, Corporation Commission, in which he said:

"As you will understand we are not operating on piece of road west of Bowden, but are simply hauling fertilizer, etc., for the accommodation of people in that territory. We would be money ahead by discontinuing this service, and will do so if you deem it necessary, but in the meantime, we will do the best we can to give them all the service possible. We have left one locomotive at Bowden to attend to this business and hope to give them better service this year than we have in the past. On the two points, Newton Grove and Eureka Church, however, there will be some delay, and we have notified all shippers whom we know that we do not care to handle this business except in that way."

There is attached hereto and marked Exhibit "B," a schedule of the rates of the Enterprise-Whiteville Lumber Company over its logging road, effective December 1, 1920, as filed with the Corporation Commission, which schedule shows the limitation as to the commodities carried and allowed to be carried by this road.

These logging roads and others similar to them are not classed as railroads and as full common carriers by the Corporation Commission for the reasons above shown, for the reason that their business of carriage of property of others is purely incidental to their business of logging and manufacturing lumber, and is negligible in amount, and for the reason that they maintain no regular schedule of trains, but run simply when there is particular demand for a particular carriage.

R. O. SELF,
Affiant.

Subscribed and sworn to before me this 5th day of June, 1922.

[SEAL.]

W. H. PITTMAN,
Notary Public.

My commission expires July 29, 1922.

EXHIBIT "A."

Rowland Lumber Company.

Norfolk, Va., May 21, 1918.

To the Corporation Commission of North Carolina:

The Rowland Lumber Company respectfully sheweth to the Corporation Commission of North Carolina:

1. That it is a corporation incorporated under the laws of the State of North Carolina, authorized to engage in the Lumber business. In the operation of its timber it has purchased, and caused to be constructed, for logging purposes, a line of railroad running from Bowdens and Warsaw, on the Atlantic Coast Line Railroad, in Duplin County, North Carolina, in a westerly direction for about twenty miles toward Newton Grove.

2. Your petitioner has been, and is continually being, requested by the citizens living along the line of this road to transport freight for them and others; your petitioner is willing to accommodate such parties under present conditions, provided it can do so lawfully.

3. Under Revisal of 1905, Sec. 2598, as amended by Chapter 160, Laws of 1911, your Honorable Body is empowered to authorize this company to transport commodities, and to charge therefor reasonable rates, in addition to the transportation of its own commodities:

Wherefore, your petitioner respectfully prays, that your Honorable Body authorize your petitioner to transport over its logging road, as freight, commodities in carload lots, but excluding lumber and logs, purchased and used along the line of said road, and to make charges therefor; and that this authority be continued from year to year until your petitioner shall give to this Honorable Body necessary notice of its intention to discontinue said service.

Respectfully submitted,

(S.) ROWLAND LUMBER COMPANY,
By A. R. TURNBULL,
President and General Mgr.

EXHIBIT "B."

Rates of Enterprise Lumber Company Railroad.

Effective December 1, 1920.

Fruit and vegetables, per crate.....	20	20	25	25	25
Fruits and vegetables, per car.....	1500	1650	2000	2250	2500
Empty Crates or Barrels, ".....	1500	1650	2000	2250	2500
Ditto each.....	10	10	12½	15	15
Fertilizers, 20 Tons Maximum.....	2500	2600	3250	3500	4000
Fertilizers from 10 to 20 tons, per ton minimum 1,500 per car.....	150	175	200	225	275
L. C. L. per ton.....	300	300	350	400	450
Cotton Seed and Hulls.....	2000	2200	2700	3000	3300
L. C. L. per ton.....	200	250	325	375	400
Holly, Lime and Flour in carload.....	2000	2200	2600	2800	3000
Wood—Minimum 10 cords, per c.....	100	100	110	125	150
Cotton, per bale.....	150	150	150	175	175
Furniture, per 100 pounds.....	25	27	30	30	35
Chickens and eggs, per crate.....	30	20	30	30	30
Mdsc. not classed, per 100.....	20	20	25	25	30
Brick, minimum 10 per m.....	300	300	300	300	350

All freight is to be loaded and unloaded at expense and risk of shipper. We will not accept any freight either carload or L. C. L. from or to any point except the following:

Oliver's Siding.....	3
Taylor's Siding.....	3½
Loftin's Siding.....	3½
King's Crossing.....	5½
Dobson's Crossing.....	7¼
Hill's or Cherry's Siding.....	9½
Scott's Store.....	12
Brown's Camp or Snow Hill.....	13
Woodland Siding C. L. only.....	16
Kornegay's Bridge " ".....	17

All cars have to — unloaded on the same day they are placed, or demurrage will be charged. No freight will be shipped collect: Package freight will be carried out only on Fridays and if placed at warehouse on any day previous to Thursday it will be held by this Company at the shipper's risk. Carload shipments will be taken out any day in the week.

ENTERPRISE LUMBER COMPANY.
THOMAS O'BERRY,
General Mgr.

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Affidavit of O. S. Thompson.

Filed June 5, 1922.

In the District Court of the United States for the Eastern District of North Carolina.

In Equity.

SOUTHERN RAILWAY COMPANY et als., Plaintiffs,

vs.

A. D. WATTS and A. D. WATTS, as Commissioner of Revenue, et als.,
Defendants.

Railroad Income Tax Suits.

Affidavit of O. S. Thompson.

O. S. Thompson being duly sworn, deposes and says:

Since 1906 affiant has been connected with the Corporation Commission of North Carolina, and with the State Department of Revenue since its creation in 1921. The Corporation Commission, in addition to its duties as such, was by statute created the State Tax Commission with the duties of administering the tax laws of the State. Affiant's position with the said State Tax Commission was that of Tax Clerk, and as such his duties were the general super-

vision of the details of the administration of the tax laws of the State. While Tax Clerk of the State Tax Commission affiant had extensive experience with the Standard Classification of Accounts of the Interstate Commerce Commission in connection with preparing the reports of the Corporation Commission based in part on the said Standard Classification.

Affiant is now Deputy Commissioner of Revenue of North Carolina and acting Chief Clerk of the State Department of Revenue and his duties as such are similar to those formerly performed by him as Tax Clerk of said State Tax Commission. Prior to 1906 affiant served as an employee of the Southern Railway Company as clerk handling taxation matters.

In his capacity as Deputy Commissioner of Revenue and acting Chief Clerk of the State Department of Revenue the affiant is familiar with the requirements of that Department as to returns for taxation by taxpayers, with the forms of such returns, and is custodian of the records of the State Department of Revenue. Affiant is familiar with the administration of the tax laws of the State by the State Department.

The State Department of Revenue has only one blank for returns for income tax which is sent out to and used by all railroad corporations engaged in the operation of railroads. This is known as Form 7, and is attached to this affidavit, marked Exhibit A. This form is required by the State Department of Revenue to be filled out by all railroads doing business in the State of North Carolina, whether operating partly within or partly without the State, whether operating wholly within the State but as common carriers with interstate railroads, or whether doing wholly intrastate business. This Form 7 requires a report by all such railroad corporations of their net income as defined by the Income Tax Act of 1921, under the provisions of section 202 of that Act, and based upon and according to the Standard Classification of Accounts of the Interstate Commerce Commission.

59 The State Department of Revenue requires all such railroad corporations to make return for income taxation upon this form and ascertain the net income of such railroads for taxation without discrimination according to the provisions of the said section 202.

Affiant has read the affidavits of Nathan O'Berry, President of the Enterprise-Whiteville Lumber Company, and of Mr. A. R. Turnbull, President of the Rowland Lumber Company, filed in their suits by the Norfolk and Southern Railway Company. It is true that these lumber companies and other similar companies are not classed as railroads by the State Department of Revenue, are not treated as railroads for income tax purposes or for any other purposes whatsoever, and are not required to make returns for income tax according to the Standard Classification of Accounts and upon Form 7, but are required to and do make return for income tax on Form 3, which is the Form required by the Department for corporations in general other than the railroads and other public service corporations taxed according to section 202. In fact, these lum-

ber companies and other similar companies are not railroads and are not public-service corporations. As is stated in the said affidavit by the presidents, their principal business is the lumber business, only such transportation as they carry on is principally the transportation of their own property as incident to the lumber business. Under section 3413, Consolidated Statutes, the Corporation Commission has the power to grant to such companies authority to transport certain commodities other than their own property, subject to the supervision of the Commission, but the affiant is informed and believes that the purpose of such provision is simply to allow such companies to accommodate immediate communities in which they operate; that when such authority is granted to and exercised by such companies they do not engage in the business of transportation as common carriers for others for profit, but only as the purely incidental service of accommodation; that in any such case the transportation of property of others by such a corporation is wholly negligible in amount and purely incidental to the principal business of the corporation, which is the lumber business.

Affiant states, therefore, as a matter of his own knowledge, that the Income Tax Act of 1921, as administered by the State Department of Revenue, applies exactly in the same way and without any discrimination whatsoever to all railroad corporations doing any business in the State engaged in railroad operation, whether foreign or domestic, whether operating partly within and partly without the State, or wholly within the State. All are required to make return for income tax according to the Standard Classification of Accounts and under section 202, and exactly the same deductions are allowed to all, without discrimination.

Not only is the entire class of railroads subjected to income taxation under the provisions of section 202 with ascertainment of net income upon the basis of the Standard Classification of Accounts, but the same is true as to the broader class of all strictly public service corporations, not including such lumber companies as are above referred to and which the affiant is informed and believes are not public-service corporations at all.

The State Department of Revenue has one form for income tax return for all public service corporations other than railroads, Form 8, a copy of which is attached hereto and marked Exhibit B, and which form is substantially identical with Form 7 upon which railroads are required to make return. The Department of Revenue requires, therefore, not only of railroads, but of all other public service corporations, that they file returns for income tax upon the basis of the Standard Classification of Accounts, under the provisions of section 202.

60 Affiant has read the affidavit of Mr. J. H. Bridges, President of the Henderson Water Company, in which Mr. Bridges states that the Henderson Water Company is not required to and does not keep its records according to the Standard Classification of Accounting, and that it did not make return for income taxation according to the said classification under the provisions of section 202. Affiant states that the returns for income taxation in the office

of the Department of Revenue for the year ending December 31, 1921, have not yet been audited and checked for correctness. If what Mr. Bridges says with reference to the return made by the Company is true, his company will be required to amend its return and to file a return on Form 8 according to the said Standard Classification and under the provisions of section 202. As the Department of Revenue interprets the Income Tax Act, the Henderson Water Company, as well as all other public service corporations, are required by it to make return for income tax in accordance with the accounting system of the Standard Classification. The auditing of income tax returns for the said year is in progress at this time, but has not been completed, and, with reference to railroads and other public-service corporations, has been held over pending decision in these suits as to the validity of the income tax as to such corporations, in view of the plaintiff's attack upon the income tax law as applied to them.

O. S. THOMPSON,
Affiant.

Subscribed and sworn before me this the 5th day of June, 1922.

W. H. PITTMAN,
Notary Public.

My commission expires July 29, 1922.

61

Affidavit of F. C. Harding.

Filed June 20, 1922.

In the United States District Court for the Eastern District of North Carolina.

NORFOLK SOUTHERN RAILROAD COMPANY

vs.

A. D. WATTS, Commissioner of Revenue, et al.

F. C. Harding, being duly sworn, deposes and says, that he is the President of the Greenville and Shelberdine Railroad Company; that the same was chartered in 1920; that the road is 12 miles long, extending from Greenville to Shelberdine and is of narrow gauge. That W. L. Hall is the Secretary of said Railroad Company and that David Hoots is General Superintendent, Engineer and Conductor. That this road has no office, either in Greenville or at Shelberdine or along the route of its railroad. That this road makes, as a general thing, one trip a day.

During the movement of fertilizer in the spring, it often makes two trips a day. That it carries freight for hire, from Greenville to any point along the road to Shelberdine and from Shelberdine to any point along the road to Greenville. That it issues no bills of lading.

That the freight it carries from Greenville to Shelberdine, or along the route, is removed from the Atlantic Coast Line Railroad Co. cars and placed in this company's car and is delivered along the route to its several patrons. That while people along the route use this road as a convenience to travel, this company has never charged any passenger rates. That this company has never made any report to the State Corporation Commission or to the Internal Revenue Commissioner and of course has never made any interstate report as it does not do any interstate business as all of its business is intrastate. That this road is not a lumber road. It was originally built for a lumber road but when the Beaufort County Lumber Co. removed from Pitt County, the road was purchased by the present owners who afterwards incorporated under the style above named.

Affiant further states that the Greenville and Shelberdine Railroad Company does not keep its accounts according to the standard classification of accounting promulgated by the Interstate Commerce Commission.

(S.)

F. C. HARDING.

Subscribed and sworn to before me this 20th day of June 1922.

(S.)

M. V. HARDING,

Notary Public.

My commission expires Nov. 3, 1922.

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Affidavit of Ernest Williams.

Filed June 20, 1922.

In the District Court of the United States for the Eastern District of North Carolina.

NORFOLK SOUTHERN RAILROAD COMPANY

vs.

A. D. WATTS, Commissioner of Revenue, et al.

Affidavit of Ernest Williams.

Ernest Williams, being first duly sworn, deposes and says, that he is President of the Durham & South Carolina Railroad Company; that during the year 1921 the line of railroad owned by the Durham & South Carolina Railroad Company, extending from Durham, North Carolina, to a connection with the line of railroad owned by Norfolk Southern Railroad Company, at Duncan, North Carolina, was under lease to Norfolk Southern Railroad Company for a term of years which has not yet expired.

That Norfolk Southern Railroad Company duly paid the rental required by the said lease, and that the payment of the said rental was a condition precedent for the continued use of said property in the trade or business of Norfolk Southern Railroad Company, and

the rent so paid was substantially the entire income of the Durham & South Carolina Railroad Company.

That Norfolk Southern Railroad Company has not taken title, nor is it taking title, nor has it any equity in the property.

(S.)

ERNEST WILLIAMS.

Subscribed and sworn to before me this 20th day of May, 1922.

[SEAL.]

Florence H. Gilbert,

Notary Public.

My commission expires on the 3rd day of August, 1925.

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Affidavit of C. D. Bradham.

Filed June 20, 1922.

In the District Court of the United States for the Eastern District of North Carolina.

NORFOLK SOUTHERN RAILROAD COMPANY

vs.

A. D. WATTS, Commissioner of Revenue, et al.

Affidvit of C. D. Bradham.

C. D. Bradham, being first duly sworn, deposes and says that he is President of the Atlantic & North Carolina Railroad Company; that prior to the year 1921, the Atlantic & North Carolina Railroad Company leased to the Howland Improvement Company its line of railroad, extending from Morehead City to Goldsboro, North Carolina.

That the Norfolk Southern Railroad Company is the successor in title to the said leasehold interest granted by said lease and during the year 1921 was in possession of said line of railroad under said lease and used the same exclusively and conducted and carried on the business of a common carrier over said line of railroad.

That during the said year 1921, Norfolk Southern Railroad Company paid the Atlantic & North Carolina Railroad Company the amount of rent required by said lease to be paid for the continued use of said property in the trade or business of Norfolk Southern Railroad Company; that the payment of the said rent was a condition precedent to the continued use of the said property by the Norfolk Southern Railroad Company in its business.

That the Norfolk Southern Railroad Company has not taken title to the said property, was not taking title thereto, and has no equity in the property owned by the Atlantic & North Carolina Railroad Company.

That under the terms of the said lease, Norfolk Southern Railroad Company, as Lessee, is required to pay any Income Tax levied upon the income of the Atlantic & North Carolina Railroad Company derived from or under said lease.

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That the amount of money received from Norfolk Southern Railroad Company as rent for the use of said property is substantially the entire income of the Atlantic & North Carolina Railroad Company.

(S.)

C. D. BRADHAM.

Subscribed and sworn to before me this 17 day of May, 1922.

(S.)

H. J. CARPENTER,

[SEAL.]

Notary Public.

My commission expires on the 7th day of Oct. 1922.

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Affidavit of M. S. Hawkins.

Filed June 20, 1922.

In the District Court of the United States for the Eastern District of North Carolina.

In Equity.

NORFOLK SOUTHERN RAILROAD COMPANY

vs.

A. D. WATTS et al.

Affidavit of M. S. Hawkins.

M. S. Hawkins, being first duly sworn, deposes and says that he is Secretary of Norfolk Southern Railroad Company, having occupied that position since the Company's organization in 1910.

If it is intended by the affidavit of A. J. Maxwell filed in this cause to suggest that the capital stock of this Company was issued as a bonus or gift, such statement is incorrect and untrue.

Norfolk & Southern Railway Company, predecessor in title of complainant, in many of its properties, issued and sold mortgage bonds to the amount of fourteen million dollars and also certain capital stock, as appears from the records of that company.

Norfolk & Southern Railway Company, being unable to meet its obligations as they matured, the Mortgage securing the bonds was foreclosed and the property was sold and bought by a committee of bondholders who issued the capital stock of the present Norfolk Southern Railroad Company to the bondholders of the Old Norfolk & Southern Railway Company in lieu of the said bonds and stocks.

Under no system of accounting that affiant has ever seen or heard of, can interest paid by an operating corporation be properly charged as a capital expense. Capital expenses are supposed under all proper systems of accounting to represent expenditures made to increase the assets of the Company, while interest is a liability incurred for the use of money borrowed and chargeable to income, and constitutes a liability and not an asset.

A system of accounting which provides for entering interest paid

by an operating corporation as a capital expenditure would be incorrect, misleading and calculated to lead to gross errors, if nothing more.

One of the chief differences between interest and dividend is that interest is a direct obligation of the borrower to pay the lender for the use of money, whether a profit is made or not, while dividends are not a direct obligation to pay at all hazards, as is interest, but dividends can properly be payable only out of net earnings of the business after all expenses, (including interest) and losses, are paid, adjusted, liquidated or taken care of, leaving the capital intact.

Under the Income Tax Laws of North Carolina, as affiant understands them, as to individuals and all corporations other than those required to keep records according to the standard classification of accounting of the Interstate Commerce Commission, the payee, or recipient of the interest, (lender of the borrowed money on which interest accrues) is required to include interest received (except that on certain governmental obligations) in his or its gross income for the purpose of ascertaining the net income subject to tax, and the payer of such interest (borrower of the money) deducts the interest thus paid from his or its gross income, while in the case of dividends the payee, or recipient of the dividends, excludes or omits the dividends from his or its gross income, and the payer of such dividends includes the amount paid as a part of his or its taxable income (provided that the payer pays an income tax to the State) thus the amount so paid as either interest or dividends is only taxed as income one time.

In case of corporations required to keep records according to the standard classification of accounting of the Interstate Commerce Commission (if the statute is held constitutional) both the payee of the interest (that is the lender of the money) and the payer of the interest (the borrower of the money) will be compelled to include the interest received and paid in their gross income, for taxation without allowing any deduction to either, thus making double taxation.

So with rent paid for use of property by individuals and corporations, other than those required to keep records according to the standard classification of accounting of the Interstate Commerce Commission, the payee or lessor of certain property includes rent received in his or its gross income, and the payer of the rent, or lessee of the property, deducts the amount of rent paid from his or its gross income, and the money representing such rent is taxed once only for income purposes, while under the statute, (if constitutional) corporations keeping their records according to the standard classification of accounting of the Interstate Commerce Commission, renting property for use in the business, the payee or lessor of the property, must include the rent received for the use of such property in his or its gross income for the purpose of income taxation, and the payer of such rent, or lessee, is not permitted to deduct such rent from its gross income in order to arrive at the net income taxable, and, therefore, subjecting the rent to double taxation, thus creating a direct discrimination or double taxation on those corporations

which are required to keep their records according to the standard classification of accounting of the Interstate Commerce Commission.

Affiant is advised that only those corporations engaged in operating steam or electric railroads in transportation of passengers and property in Interstate Commerce, and pipe lines carrying certain commodities, and of intelligence, are required to keep records in accordance with the standard classification of accounting of the Interstate Commerce Commission, and therefore, as affiant is advised, informed, and believes, corporations that are engaged in Interstate Commerce in the manner above indicated are penalized for transacting and carrying on interstate commerce.

Affiant is informed, believes and alleges that it is not the general rule that corporations operating railroads engaged in transporting freight and passengers in interstate commerce are financed almost entirely by bond issues.

Norfolk Southern Railroad Company is not financed in that way. As of December 31, 1921 the Company has outstanding capital stock of the par value of sixteen million dollars, and its funded debt was \$19,608,600.00.

Affiant avers that Moody's publication of the financial condition of industrial corporations is a standard authority for the financial condition of such corporations.

An examination of that publication issued for the year 1922 discloses that as to the corporations hereinafter named, which affiant is informed, believes and alleges were during the income tax year 1921, and are now engaged in operating and doing business in the State of North Carolina, as to their relative capital stock issue and funded debt, and bills and accounts payable, as follows, to-wit:

Liggett & Myers Tobacco Co., capital stock \$55,188,300, funded debt \$29,320,600.

Royster Guano Company, capital stock \$2,473,800, and stock of subsidiaries \$331,800, funded debt \$2,500,000, bills and accounts payable \$4,252,175.00.

Virginia Carolina Chemical Company, capital stock \$48,652,972.00, bonds \$26,267,000, bills payable \$27,421,708, total of bonds and bills payable \$53,689,403.00.

Armour & Company, capital stock \$150,000,000.00, bonds \$115,560,900, bills payable \$129,198,913.00.

Consolidated Textile Corporation, capital stock \$26,452,195 with a foot note stating "representing capital, surplus and 801,039 shares of no par value." Bonded debt of \$12,500,000, bills and accounts payable \$14,706,360.00.

Affiant has not had access to Moody's publication as to public utilities for the year 1922, but such publication for the year 1921, as to public utility corporations, discloses that as appears therein, the relative capital stock issue and bonded indebtedness of some of

the public utility corporations, which as affiant is informed, believes and alleges, are not required to keep records in accordance with the standard classification of accounting of the Interstate Commerce Commission, were as follows:

Southern Power Company, capital stock ten million dollars, bonded debt seven million dollars.

Asheville Power & Light Company, of Asheville, N. C., capital stock \$1,639,700, bonded debt \$1,220,000.

Southern Public Utilities Company, capital stock six million dollars, underlying bonds \$1,773,500.00, 5% gold bonds \$4,487,700.

Affiant avers that the real and true difference in financing corporations operating railroads engaged in transporting passengers and property in interstate commerce on the one side and industrial corporations and public utility corporations on the other side, and the reason therefor, arose out of the legal restrictions which have from time to time been placed on and around such railroad corporations and from which industrial corporations are free, i. e. such railroad corporations are not allowed to issue any bonds, stocks or securities except a limited amount of short term notes, until and only to the extent that the duly authorized governmental body shall after investigation find and certify that the issuance of such securities is for some lawful object within its corporate purposes and is compatible with the public interest and is necessary or appropriate and consistent with the proper performance of service to the public and will not impair the ability of such corporation to perform that service and is reasonably necessary for that purpose and after full and complete showing as to the terms upon which the securities are to be sold and the rate of interest they are to bear, while ordinary industrial corporations and many public utility corporations are allowed to issue and sell their securities upon such terms and for such purposes as to them may seem proper; that such railroad corporations are by law prevented from accumulating out of earnings funds with which to discharge (except to a very limited extent) money borrowed to supply the necessary public service, unless such money can be borrowed at a much lower rate than has obtained in the money markets of the world in the last several years, and at a lower rate than the law allows such railroad corporations to earn upon the value of their property devoted to public use, to-wit, $5\frac{1}{8}$ per cent, or unless such railroad corporations deprive the holders of their stock of returns for the use of money invested in such capital stock, and devote the same, if earned, to the discharge of the principal of bonds or securities issued for the benefit of the public, while ordinary industrial corporations are allowed to earn any rate of return which they can, so far as any inhibition of the law provides; that the corporations operating railroads transporting passengers and freight in interstate commerce may be compelled, under heavy penalties, to provide funds with which to furnish services to the public, or quit entirely, which they are not permitted to do, unless and until they have obtained authority so to do from governmental bodies, which authority may be issued only and to the extent that after such investigation the governmental body finds that the public will not be unduly inconvenienced, while industrial corporations are allowed to issue securities whenever they desire, or desist from issuing them, and if they so desire shut down and quit without leave of license from any person or governmental authority whatsoever.

That all the advantages of financing and paying off and discharging loans is with industrial corporations and the limitation of the law against corporations operating railroads transporting freight and passengers in Interstate commerce compel and require them to resort, as far as possible, to the borrowing of money upon long terms, and thus creating obligations which they would not have if the laws were so designed and enacted as to enable such corporations to sell their capital stock.

M. S. HAWKINS.

Sworn and subscribed to before me this 9th day of June, 1922.
J. R. PRITCHARD,
Notary Public.

My commission expires on the 10th day of January, 1925.

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Affidavit of A. R. Turnbull.

Filed June 20, 1922.

In the District Court of the United States for the Eastern District of North Carolina.

RAILROAD COMPANY, Complainant,

vs.

A. D. WATTS, Commissioner of Revenue of North Carolina, et al.,
Defendants.

A. R. Turnbull, being first duly sworn, deposes and says:

1. That he is President of the Rowland Lumber Company.
2. Rowland Lumber Company is a corporation duly organized and existing under the laws of the State of North Carolina, the principal business of the said company is the manufacture of lumber.
3. That it operates a large mill in North Carolina, located at Newbern, and has under lease a line of railroad extending from Clarks Junction, a point on the Atlantic & North Carolina Railroad, westwardly to a point beyond New River and thence to Chinquapin, and a few miles beyond, where it connects with a line of railroad owned by Rowland Lumber Company, which extends to Kenansville, where it connects with a line of railroad owned by Atlantic & Carolina Railroad Company.
4. The principal business of the said railroad running from Kenansville to Clarks Junction, through Chinquapin is the transportation of logs and lumber for the owner of such railroad.
5. The Corporation Commission of North Carolina, acting under the power vested in it by section 3413 Consolidated Statutes of North Carolina, has granted to Rowland Lumber Company authority

to transport commodities of certain kinds and character other than owned by the said Rowland Lumber Company over that part of the said line of railroad between Kenansville and Chinquapin and to charge therefor a scale of rates fixed and established by the Corporation Commission of North Carolina.

6. Rowland Lumber Company does transport for others than itself commodities of the kind and character authorized by said authority to be transported and charges therefor the scale of rates authorized by the Corporation Commission.

7. That the Rowland Lumber Company is not engaged in interstate commerce and has never filed any tariffs with the Interstate Commerce Commission, and has not been authorized to engage in interstate commerce, and is prohibited under the law from so doing until it has filed tariffs with the Interstate Commerce Commission as required by the Interstate Commerce Act.

8. That during the calendar year 1921, which is the income tax year for 1921 in the state of North Carolina, Rowland Lumber Company paid rent for the line of railroad operated by it as aforesaid and also paid other rents for properties used in its said business and to which it had not taken and was not taking title, and to which it had no equity except its leasehold, and also paid sums as interest for money borrowed and used in its business.

9. Affiant is informed and believes that Rowland Lumber Company is, under the income tax law of North Carolina, schedule D, of Chapter 34, entitled to deduct the amounts so paid as interest and rent, together with other deductions allowed by said schedule from its gross income, in order to arrive at its net income subject to tax under the said tax laws of North Carolina.

10. That the said railroad is of standard gauge and can and does receive cars from other lines of railroad, which it transports to destination on its own line.

A. R. TURNBULL.

Sworn and subscribed to before me this 20th day of May, 1922.

[SEAL.]

J. R. DEY, JR.,
Notary Public.

Com. expires Sept. 18, 1923.

Affidavit of Nathan O'Berry.

Filed June 20, 1922.

In the District Court of the United States for the Eastern District of
North Carolina.

RAILROAD COMPANY, Complainant,

vs.

A. D. WATTS, Commissioner of Revenue of North Carolina, et al.,
Defendants.

Nathan O'Berry, being first duly sworn, deposes and says:

1. That he is a citizen and resident of the State of North Carolina and County of Wayne, that he is President of Enterprise-Whiteville Lumber Company.

2. That said company is an industrial corporation engaged in operating lumber mills located respectively at Whiteville and Mt. Olive, North Carolina.

3. That said company, as a part of its business constructed a line of railroad extending from Whiteville, N. C., to Butlers, N. C., a distance of about 27 miles, and also constructed a line of railroad extending from Mt. Olive, N. C., to New Camp, N. C., a distance of about 18 miles.

4. That said railroads were established and maintained solely by the owner of the lands upon which the said roads were constructed and the principal business of said railroad is the transportation of logs, lumber and other articles of the owners of said railroad.

5. Acting under the provisions of section 3413 of the Consolidated Statutes of North Carolina, the said corporation applied to the Corporation Commission of North Carolina for authority to said corporation to transport between the termini of said two lines of railroad, commodities other than that owned by the said lumber company, and for authority to charge therefor reasonable rates to be approved by said corporation.

6. The Corporation Commission, under the powers vested in it under said section 3413 of the Consolidated Statutes of North Carolina, duly authorized the said corporation to act as a common carrier between the termini of its said two lines of railroad and established a scale of rates which said corporation might charge for the transportation of the kind and character of commodities
73 which it was authorized to transport for others for such services.

7. That the said Corporation does not have any Tariff filed with Interstate Commerce Commission, and is not authorized to and does

not engage in the transportation of freight or passengers in interstate commerce, or between any points other than those on its own line. That the said corporation, during the year 1921, paid interest on account of money borrowed, that the said corporation in making its income tax returns to the Commissioner of Revenue of the State of North Carolina, deducted from its gross income the interest so paid in order to arrive at its net income, this deduction being made in addition to the other deductions allowed under section 306, schedule D of the Revenue Act of North Carolina.

8. This affiant is informed and believes that it was entirely proper under the laws of North Carolina for said corporation to deduct the interest paid during the year 1921 from its gross income, together with the other deductions allowed in section 306 of schedule D Revenue Act of North Carolina from its gross income in order to ascertain the net income subject to tax.

NATHAN O'BERRY.

Sworn and subscribed to before me this 17th day of May, 1922.

[SEAL.]

G. W. BRINKLEY,

Notary Public.

My Commission expires Jan. 24, 1924.

74 *Affidavit of J. C. Nelms, Jr. (May 18, 1922).*

Filed June 20, 1922.

In the District Court of the United States for the Eastern District of North Carolina.

NORFOLK SOUTHERN RAILROAD COMPANY, Complainant,

vs.

A. D. WATTS, Commissioner of Revenue of North Carolina, et al.,
Defendants.

Affidavit.

J. C. Nelms, Jr., being first duly sworn, deposes and says:

That he is a citizen and resident of the County of Norfolk, and State of Virginia; that he is General Auditor of Norfolk Southern Railroad Company and has occupied that position since April, 1915; that he is familiar with the rules of accounting for steam and electric railroads as prescribed by the Interstate Commerce Commission.

On the 19th of May, 1914, effective July 1, 1914, the Interstate Commerce Commission issued orders classifying the accounts of steam railroads, and dividing the accounts into two classes:

- (1) Operating Revenues and Operating Expenses; and,
- (2) Income, Profit and Loss, and General Balance Sheet Accounts.

These rules are still in force, subject to such modifications and explanations as have been made by the Commission since that date.

That the order prescribing the classification of Operating Revenues and Operating Expenses of Steam Roads, among other things provided:

"It is ordered, That, the Classification of Operating Revenues and Operating Expenses of Steam Roads and the text pertaining thereto, embodied in printed form to be hereafter known as Issue of 1914, a copy of which is now before this Commission, be, and is hereby, approved; that a copy thereof duly authenticated by the Secretary of the Commission be filed in its archives, and a second copy thereof, in like manner authenticated, in the office of the Division of Carriers' Accounts; and that each of said copies so authenticated and filed shall be deemed an original record thereof.

75 "It is further ordered, That the said Classification of Operating Revenues and Operating Expenses of Steam Roads, with the text pertaining thereto, be, and is hereby, prescribed for the use of carriers by rail (exclusive of electric railways) subject to the provisions of the Act to Regulate Commerce as amended, in the keeping and recording of their operating revenue and operating expense accounts; that each and every such carrier and each and every receiver or operating trustee of any such carrier be required to keep all operating revenue and operating expense accounts in conformity therewith; and that a copy of said issue be sent to each and every such carrier and to each and every receiver or operating trustee of any such carrier."

This affiant has a copy of the said order and the classification of accounts and instructions accompanying the same.

Accompanying said order, as sent to the carriers, was an introductory letter, which among other things stated that:

"Accounts are provided in this classification for the revenues and expenses of operations which heretofore have been classed as auxiliary or outside operations. The purpose in merging these accounts has been to secure a statement of revenues and expenses in connection with the operation of all physical property the cost of which is includible in the accounts for investment in road and equipment. The accounts for maintenance of physical property have been arranged to correspond with those for the investment in such property. Depreciation accounts have been provided for the current depreciation of fixed improvements, although until further directed the recognition in operation expenses of current depreciation of fixed improvements is optional with the carrier. It is provided that organization and general administration expenses directly assignable to investments in stocks, bonds, and other securities shall be excluded from the accounts of this classification and included in income account No. 549, "Maintenance of investment organization."

There also accompanied said order and classification certain general instructions, among which were the following:

"1. Operating Accounts.—The accounts of this classification are designed to show the revenues and expenses (including the maintenance of the facilities used) of the carrier's railway operations, including rail-line transportation, water-line transportation, if any, and services incident to transportation. Transportation includes the receipt, conveyance, and delivery of traffic."

"4. Miscellaneous Operations.—The revenue and expenses of miscellaneous operations involving the use of such facilities as hotels and restaurants, power plants, cold-storage plants, coal-storage plants, cotton compress plants, wood-preserving plants, ice-supply plants, etc., shall not be included in the accounts of this classification when the facilities used are distinct from those used by the carrier in the service of transportation or in the maintenance of facilities used in transportation service, and the operations are not incident to such service. (See income accounts No. 502, "Revenue from miscellaneous operations," and No. 534, "Expenses of miscellaneous operations," and balance-sheet account No. 705, "Miscellaneous physical property.")"

There also accompanied said order certain special instructions, among which was:

"1. Accounts for Operating Revenues.—The accounts provided for operating revenues are designed to show amounts of money which a carrier becomes entitled to receive from transportation and from operations incident thereto."

The Operating Revenue accounts were by the said classification divided into general accounts and primary accounts. A statement of the general accounts and primary accounts for steam railroads, according to the said classification, showing the number of each account, as set out in said rule and order is hereto attached marked Exhibit A and prayed to be taken as a part of this affidavit.

The said order prescribed that account 142 "Rents of Buildings and other property," should include: "the revenue from the exclusive use of buildings and other property or portions thereof, such as depot and station grounds and buildings, general and other offices, wharves, ferry landings, elevators, stockyards, fuel yards, enginehouses, repair shops, and section and other houses, when the property is operated and maintained in connection with the property used in the carrier's transportation operations and the expenses of maintaining and operating the rented portion cannot be separated from the expenses of that portion used by the carrier."

As to the General Account No. IV, Joint Facility, being primary accounts Nos. 151 and 152, the said order provides that these accounts should include the carrier's proportion of revenue collected by others in connection with the operation of joint tracks, yards, terminals and other facilities, and also that proportion of revenue from the operation of joint tracks, yards terminals and other facilities, which is creditable to other companies.

The account did not include the rent paid for the use of the joint facilities, simply results of operations.

The operating expenses were by said order divided into eight general accounts, and into quite a number of primary accounts. A statement is hereto attached showing the general and primary accounts of steam railroads. Said statement is marked Exhibit B and is

prayed to be taken as a part hereof.

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The special instructions accompanying said order, among other things, stated that: "The accounts prescribed for operating expenses are designed to show expenses of furnishing transportation service, including the expenses of maintaining the plant used in the service."

The accounts of Norfolk Southern Railroad Company are and have been kept in accordance with the rules and regulations prescribed by the Interstate Commerce Commission as set out in said orders, as explained by the instructions and orders of the Commission, modifying or explaining the aforesaid order of May 19, 1914.

The said accounts and reports made to the Commission in accordance with said rules and regulations do not contain any such term as "Net Operating Income." The reports of Norfolk Southern Railroad Company made to the Interstate Commerce Commission show the total amount of its operating revenues and also shows the total amount of its operating expenses, and also the difference between these two amounts, which in said reports, and under the rules prescribed by the Interstate Commerce Commission, is denominated and known as "Net Revenue from Railway Operations." The Net Revenue from Railway Operations of Norfolk Southern Railroad Company and of corporations operating steam or electric railroads, keeping their accounts in accordance with the standard classification of accounting of the Interstate Commerce Commission, is the difference between the amount of money which Norfolk Southern Railroad Company or such other similar corporations, receives from transportation, as the term "Transportation" is defined in the said classification of accounts and in the Interstate Commerce Act, and the amount paid out for "all the ordinary and necessary expenses paid during the income year for conducting and carrying on transportation, as transportation is defined in the said classification of accounts and in the Interstate Commerce Act, including as a part of said expenses depreciation on its equipment, to-wit: steam locomotives, other locomotives, freight train cars, passenger train cars, motor equipment of cars, floating equipment, work equipment and miscellaneous equipment, if any."

Accounts of operating revenues and operating expenses of steam railroads, such as Norfolk Southern Railroad Company, and other similar corporations, kept in accordance with standard classification of accounting of the Interstate Commerce Commission do not include all gain derived from capital or labor or both combined, provided it is understood that the term "gain" includes profit gained through a sale or conversion of capital assets.

The said operating revenues and operating expenses of steam roads does not include the following items of gain or income which such corporations may receive during any period of time, but said items or sources of revenue or gain are in accordance with said classification carried under what is known as income accounts, to-wit: revenues from miscellaneous operations, hire of freight cars, credit balance, rents from locomotives, rents from passenger train cars, rents from floating equipment, rents from work equipment, joint facility rent income, income from lease of road, miscellaneous rent income, miscellaneous non-operating physical property, separately operated properties,—profit, dividend income, income from funded securities, income from unfunded securities and accounts, income from sinking and other reserve funds, release of premiums on funded debt, contributions from other companies, and miscellaneous income, all of which are gain from labor or capital or both combined, or from a sale or conversion of capital assets.

The accounts of operating revenues and operating expenses of steam railroads, when such accounts are kept in accordance with the standard classification of accounting of Interstate Commerce Commission, do not include all of the expenses of conducting and carrying on the business of the corporation, and do not include many items of expenses which are necessary to be paid in order that the business may be carried on, to-wit: railway tax accruals; uncollectible railway revenues; expenses of miscellaneous operations; taxes on miscellaneous operating property; hire of freight cars—debit balance; rent for locomotives; rent for passenger-train cars; rent for floating equipment; rent for work equipment; joint facility rents; rent for leased roads; miscellaneous rents; miscellaneous tax accruals; separately operated properties—loss; interest on funded debt; interest on unfunded debt; amortization of discount on funded debt; maintenance of investment organization; income transferred to other companies; miscellaneous income charges; income applied to sinking and other reserve funds; dividend appropriations of income; income appropriated for investment in physical property; stock discount extinguished through income; and miscellaneous appropriations of income.

Under the aforesaid orders of the Interstate Commerce Commission dividing the accounts of corporations, operating steam railroads engaged in interstate commerce, into the two general classes as aforesaid, to-wit: Operating Revenues and Operating Expenses on the one part, and Income, Profit and Loss, and General Balance Sheet Accounts on the other, the Interstate Commerce Commission prescribed with great care and particularly the items of revenue which should go into each of the income accounts both credit and debit accounts.

A list of the primary accounts constituting the income accounts under said classification, both credit and debit is hereto attached, marked Exhibit C and prayed to be taken as a part hereof.

In addition, the said order of the Commission in prescribing rules of accounting for corporations operating steam railroads engaged in interstate commerce, prescribed a form of income statement. A copy of said form is hereto attached and made a part hereof, marked Exhibit D, and prayed to be taken as a part hereof.

79 The accounts of Norfolk Southern Railroad Company are kept in accordance with the aforesaid classification, its income statement is made to accord with the form of income statement prescribed in said rules of accounting and it reports to the Interstate Commerce Commission its operating revenues, operating expenses, other items of intake and outgo, all as prescribed by the Interstate Commerce Commission.

The term "Operation Ratio" does not appear in said rules of accounting. The term "operating ratio" is generally understood to mean and be that percent which the operating expenses as prescribed by the Interstate Commerce Commission bears to the operating revenues as prescribed by the Interstate Commerce Commission.

The difference between the operating revenue and operating expenses of a corporation operating the steam railroads in keeping its accounts in accordance with the rules of the Interstate Commerce Commission does not show or purport to show the net income of such corporations, but purports to show and shows the difference between the amount of revenue received from the business of conducting and carrying on its transportation and the operations incident thereto and the cost and expense of conducting such transportation and the incidents thereto.

In order to obtain the net income of such corporations it is necessary to consider and take into consideration the income accounts of said corporation as prescribed and shown in the rules of accounting of the Interstate Commerce Commission, and is set out in the form of income statement prescribed by the Commission, and which such railroad companies are required to make to the Commission.

Norfolk Southern Railroad Company owns and operates a line of electric railroad which runs from Norfolk to Virginia Beach and thence to Cape Henry, thence returning to Norfolk. In making reports to the Interstate Commerce Commission under the orders of the Commission the accounts of the electric division and the steam division are combined. Under permission granted by the Interstate Commerce Commission, Norfolk Southern Railroad Company keeps records showing the accounts of the electric division or electric railroad separate from the steam division or steam railroad. No part of the electric railroad is situated in North Carolina. The steam railroad extends and is situated both in North Carolina and Virginia. The ratio of operating expenses to operating revenue of the electric division was for the year 1921, 74.37% and for the steam division 84.51%, and for the entire system including both steam and electric divisions, 83.81%. That is to say that out of every dollar received by Norfolk Southern Railroad Company in payment for services rendered in the conduct of transportation on its electric division, as transportation is defined in classification of accounts of the Interstate Commerce Commission, it paid out in operating expenses, as

80 such operating expenses are defined in said classification of accounts, 74.37 cents. That or its steam division, which is located partly in North Carolina and partly in Virginia, where the business is both local and through, in both states, out of every dollar taken in for services rendered in the conduct of transportation,

both intra and interstate, it became necessary to pay, and the company did pay in operating expenses as operating expenses are defined in said classification, the sum of 84.51 cents. That considering its entire system, both electric and steam, out of every dollar taken in payment for services rendered in transportation, both interstate and intrastate, as transportation is defined in the standard classification of accounting of the Interstate Commerce Commission, it becomes necessary for Norfolk Southern Railroad Company to pay for operating expenses in conducting transportation, as transportation is defined in the classification of accounting of the Interstate Commerce Commission 83.81 cents.

That in addition to the operating expenses aforesaid it became necessary for Norfolk Southern Railroad Company, in order to conduct and carry on its business and especially its business on steam division, to pay sums and items as set out in section 23 of the bill of complaint filed in this case.

During the calendar year 1921, which was the income year 1921, Norfolk Southern Railroad Company paid expenses for conducting and carrying on its business which are not included under the head of operating expenses under the rules of accounting of the Interstate Commerce Commission, as follows, to-wit:

Joint Facility Rents, that is rents for tracks, yards, terminals and other facilities owned or controlled by other carriers, companies or individuals, and in the joint use of which Norfolk Southern Railroad Company participated, in the sum of \$37,366.96 of which \$34,009.76 was allocatable to that part of the road located in North Carolina.

For rent of roads, tracks or bridges, including equipment and other railway property covered by the contract of lease of other companies held under lease or other agreement, by the terms of which the exclusive use and control for operating purposes are secured, the sum of \$160,365.96, the entire amount of which was for properties located in North Carolina.

For the use of miscellaneous property, that is property which was not used in the operation of the railroad, but used in the conduct of its business and necessary so to be used, the sum of \$1,376.63 of which \$372.83 was allocatable to North Carolina.

For interest on its funded debt the sum of \$884,399.57 of which \$778,351.22 was and is allocatable to the State of North Carolina.

For interest on unfunded debt \$37,025.96, of which \$32,587.06 is allocatable to North Carolina.

81 For amortization of discount on funded debt, being a proportion of the discount and expense on funded debt of the company applicable to that period, in accordance with the standard rules of accounting of the Interstate Commerce Commission \$24,719.53 of which \$21,755.41 was and is allocatable to North Carolina.

Other expenses of conducting and carrying on its business which, in the standard classification of accounting of the Interstate Commerce Commission is designated as miscellaneous income charges, the sum of \$57,697.34, of which \$50,778.85 is allocatable to the State of North Carolina.

That Norfolk Southern Railroad Company had not taken title, was not taking title, and had no equity in any of the properties leased, including the railroads or joint facilities, and which are referred to as having been secured for its use in the conduct of its business by payment of the rents aforesaid.

That under the orders of the Commission, the form of accounting prescribed for operating expenses carried accounts "for the current depreciation of fixed improvements." The said orders and instructions further provided that the recognition of and charging out in operating expenses current depreciation of fixed improvements is and was optional with the carrier. Norfolk Southern Railroad Company has never charged out in its operating expenses any current depreciation for fixed improvements.

(S)

J. C. NELMS, JR.

Sworn and subscribed to before me this 18 day of May, 1922.

(S)

GILBERT C. REVEILLE,

[SEAL.]

Notary Public.

My commission expires on the 31st day of August, 1924.

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EXHIBIT A.

Operating Revenue Accounts.

General Accounts.

- I. Transportation—Rail Line.
- II. Transportation—Water Line.
- III. Incidental.
- IV. Joint Facilities.

Primary Accounts.

I. Transportation—Rail line:

- 101. Freight.
- 102. Passenger.
- 103. Excess baggage.
- 104. Sleeping car.
- 105. Parlor and chair car.
- 106. Mail.
- 107. Express.
- 108. Other passenger-train.
- 109. Milk.
- 110. Switching.
- 111. Special service train.
- 112. Other freight-train.
- 113. Water transfers—Freight.
- 114. Water transfers—Passenger.
- 115. Water transfers—Vehicles and live stock.
- 116. Water transfers—Other.

II. Transportation—Water line—

- 121. Freight.
- 122. Passenger.
- 123. Excess baggage.
- 124. Other passenger service.
- 125. Mail.
- 126. Express.
- 127. Special service.
- 128. Other.

III. Incidental—

- 131. Dining and buffet.
- 132. Hotel and restaurant.
- 133. Station, train, and boat privileges.
- 134. Parcel room.
- 135. Storage—Freight.
- 136. Storage—Baggage.
- 137. Demurrage.
- 138. Telegraph and telephone.
- 139. Grain elevator.
- 140. Stockyard.
- 141. Power.
- 142. Rents of buildings and other property.
- 143. Miscellaneous.

IV. Joint Facility—

- 151. Joint Facility—Cr.
- 152. Joint Facility—Dr.

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EXHIBIT B.

Operating Expense Accounts.

General Accounts.

- I. Maintenance of Way and Structures.
- II. Maintenance of Equipment.
- III. Traffic.
- IV. Transportation—Rail line.
- V. Transportation—Water line.
- VI. Miscellaneous operations.
- VII. General.
- VIII. Transportation for investment—Cr.

Primary Accounts.

I. Maintenance of Way and Structures—

- 201. Superintendence.
- 202. Roadway maintenance.
- 203. Roadway—Depreciation.
- 204. Underground power tubes.
- 205. Underground power tubes—Depreciation.
- 206. Tunnels and subways.
- 207. Tunnels and subways—Depreciation.
- 208. Bridges, trestles, and culverts.
- 209. Bridges, trestles, and culverts—Depreciation.
- 210. Elevated structures.
- 211. Elevated structures—Depreciation.
- 212. Ties.
- 213. Ties—Depreciation.
- 214. Rails.
- 215. Rails—Depreciation.
- 216. Other track material.
- 217. Other track material—Depreciation.
- 218. Ballast.
- 219. Ballast—Depreciation.
- 220. Track laying and surfacing.
- 221. Right-of-way fences.
- 222. Right-of-way fences—Depreciation.
- 223. Snow and sand fences and snowsheds.
- 224. Snow and sand fences and snowsheds—Depreciation.
- 225. Crossings and signs.
- 226. Crossings and signs—Depreciation.
- 227. Stations and office buildings.
- 228. Stations and office buildings—Depreciation.
- 229. Roadway buildings.
- 230. Roadway buildings—Depreciation.
- 231. Water stations.
- 232. Water stations—Depreciation.
- 233. Fuel stations.
- 234. Fuel stations—Depreciation.
- 235. Shops and enginehouses.
- 236. Shops and enginehouses—Depreciation.
- 237. Grain elevators.
- 238. Grain elevators—Depreciation.
- 239. Storage warehouses.
- 240. Storage warehouses—Depreciation.
- 241. Wharves and docks.
- 242. Wharves and docks—Depreciation.
- 243. Coal and ore wharves.
- 244. Coal and ore wharves—Depreciation.
- 245. Gas producing plants.
- 246. Gas producing plants—Depreciation.

- 247. Telegraph and telephone lines.
- 248. Telegraph and telephone lines—Depreciation.
- 249. Signals and interlockers.
- 250. Signals and interlockers—Depreciation.
- 251. Power plant dams, canals, and pipe lines.
- 252. Power plant dams, canals, and pipe lines—Depreciation.
- 253. Power plant buildings.
- 254. Power plant buildings—Depreciation.
- 255. Power substation buildings.
- 256. Power substation buildings—Depreciation.
- 257. Power transmission systems.
- 258. Power transmission systems—Depreciation.
- 259. Power distribution systems.
- 260. Power distribution systems—Depreciation.
- 261. Power line poles and fixtures.
- 262. Power line poles and fixtures—Depreciation.
- 263. Underground conduits.
- 264. Underground conduits—Depreciation.
- 265. Miscellaneous structures.
- 266. Miscellaneous structures—Depreciation.
- 267. Paving.
- 268. Paving—Depreciation.
- 269. Roadway machines.
- 270. Roadway machines—Depreciation.
- 271. Small tools and supplies.
- 272. Removing snow, ice and sand.
- 273. Assessments for public improvements.
- 274. Injuries to persons.
- 275. Insurance.
- 276. Stationery and printing.
- 277. Other expenses.
- 278. Maintaining joint tracks, yards, and other facilities—
Dr.
- 279. Maintaining joint tracks, yards, and other facilities—
Cr.

II. Maintenance of Equipment—

- 301. Superintendence.
- 302. Shop machinery.
- 303. Shop machinery—Depreciation.
- 304. Power plant machinery.
- 305. Power plant machinery—Depreciation.
- 306. Power substation apparatus.
- 307. Power substation apparatus—Depreciation.
- 308. Steam locomotives—Repairs.
- 309. Steam locomotives—Depreciation.
- 310. Steam locomotives—Retirements.
- 311. Other locomotives—Repairs.
- 312. Other locomotives—Depreciation.

- 313. Other locomotives—Retirements.
- 314. Freight-train cars—Repairs.
- 315. Freight-train cars—Depreciation.
- 316. Freight-train cars—Retirements.
- 317. Passenger-train cars—Repairs.
- 318. Passenger-train cars—Depreciation.
- 319. Passenger-train cars—Retirements.
- 320. Motor equipment of cars—Repairs.
- 321. Motor equipment of cars—Depreciation.
- 322. Motor equipment of cars—Retirements.
- 323. Floating equipment—Repairs.
- 324. Floating equipment—Depreciation.
- 325. Floating equipment—Retirements.
- 326. Work equipment—Repairs.
- 327. Work equipment—Depreciation.
- 328. Work equipment—Retirements.
- 329. Miscellaneous equipment—Repairs.
- 330. Miscellaneous equipment—Depreciation.
- 331. Miscellaneous equipment—Retirements.
- 332. Injuries to persons.
- 333. Insurance.
- 334. Stationery and printing.
- 335. Other expenses.
- 336. Maintaining joint equipment at terminals—Dr.
- 337. Maintaining joint equipment at terminals—Cr.

III. Traffic—

- 351. Superintendence.
- 352. Outside agencies.
- 353. Advertising.
- 354. Traffic associations.
- 355. Fast freight lines.
- 356. Industrial and immigration bureaus.
- 357. Insurance.
- 358. Stationery and printing.
- 359. Other expenses.

IV. Transportation—Rail line—

- 371. Superintendence.
- 372. Dispatching trains.
- 373. Station employees.
- 374. Weighing, inspection, and demurrage bureaus.
- 375. Coal and ore wharves.
- 376. Station supplies and expenses.
- 377. Yardmasters and yard clerks.
- 378. Yard conductors and brakemen.
- 379. Yard switch and signal tenders.
- 380. Yard enginemen.
- 381. Yard motormen.
- 382. Fuel and yard locomotives.

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383. Yard switching power produced.
384. Yard switching power purchased.
385. Water for yard locomotives.
386. Lubricants for yard locomotives.
387. Other supplies for yard locomotives.
388. Enginehouse expenses—Yard.
389. Yard supplies and expenses.
390. Operating joint yards and terminals—Dr.
391. Operating joint yards and terminals—Cr.
392. Train enginemen.
393. Train motormen.
394. Fuel for train locomotives.
395. Train power produced.
396. Train power produced purchased.
397. Water for train locomotives.
398. Lubricants for train locomotives.
399. Other supplies for train locomotives.
400. Enginehouse expenses—Train.
401. Trainmen.
402. Train supplies and expenses.
403. Operating sleeping cars.
404. Signal and interlocker operation.
405. Crossing protection.
406. Drawbridge operation.
407. Telegraph and telephone operation.
408. Operating floating equipment.
409. Express service.
410. Stationery and printing.
411. Other expenses.
412. Operating joint tracks and facilities—Dr.
413. Operating joint tracks and facilities—Cr.
414. Insurance.
415. Clearing wrecks.
416. Damage to property.
417. Damage to live stock on right of way.
418. Loss and damage—Freight.
419. Loss and damage—Baggage.
420. Injuries to persons.

V. Transportation—Water line—

431. Operation of vessels.
432. Operation of terminals.
433. Incidental.

VI. Miscellaneous operations—

441. Dining and buffet service.
442. Hotels and restaurants.
443. Grain elevators.
444. Stockyards.
445. Producing power sold.
446. Other miscellaneous operations.

VII. General—

- 451. Salaries and expenses of general officers.
- 452. Salaries and expenses of clerks and attendants.
- 453. General office supplies and expenses.
- 87 454. Law expenses.
- 455. Insurance.
- 456. Relief department expenses.
- 457. Pensions.
- 458. Stationery and printing.
- 459. Valuation expenses.
- 460. Other expenses.
- 461. General joint facilities—Dr.

VIII. Transportation for investment—Cr.

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EXHIBIT C.

Income Accounts.

Primary Accounts.

I. Credits:

- 501. Railway operating revenues.
- 502. Revenues from miscellaneous operations.
- 503. Hire of freight cars—Credit balance.
- 504. Rent from locomotives.
- 505. Rent from passenger-train cars.
- 506. Rent from floating equipment.
- 507. Rent from work equipment.
- 508. Joint facility rent income.
- 509. Income from lease of road.
- 510. Miscellaneous rent income.
- 511. Miscellaneous non-operating physical property.
- 512. Separately operated properties—Profit.
- 513. Dividend income.
- 514. Income from funded securities.
- 515. Income from unfunded securities and accounts.
- 516. Income from sinking and other reserve funds.
- 517. Release of premiums on funded debt.
- 518. Contributions from other companies.
- 519. Miscellaneous income.

II. Debits:

- 531. Railway operating expenses.
- 532. Railway tax accruals.
- 533. Uncollectible railway revenues.
- 534. Expenses of miscellaneous operations.
- 535. Taxes on miscellaneous operating property.
- 536. Hire of freight cars—Debit balance.
- 537. Rent for locomotives.

- 538. Rent for passenger-train cars.
- 539. Rent for floating equipment.
- 540. Rent for work equipment.
- 541. Joint facility rents.
- 542. Rent for leased roads.
- 543. Miscellaneous rents.
- 544. Miscellaneous tax accruals.
- 545. Separately operated properties—Loss.
- 546. Interest on funded debt.
- 547. Interest on unfunded debt.
- 548. Amortization of discount on funded debt.
- 549. Maintenance of investment organization.
- 550. Income transferred to other companies.
- 551. Miscellaneous income charges.
- 552. Income applied to sinking and other reserve funds.
- 553. Dividend appropriations of income.
- 554. Income appropriated for investment in physical property.
- 555. Stock discount extinguished through income.
- 556. Miscellaneous appropriations of income.

EXHIBIT D.

Form of Income Statement.

I. Operating income—

- 501. *Railway operating revenues.
- 531. *Railway operating expenses.
- *Net revenue from railway operations.
- 532. *Railway tax accruals.
- 533. *Uncollectible railway revenues.
- *Railway operating income.
- 502. Revenues from miscellaneous operations.
- 534. Expenses of miscellaneous operations.
- Net revenue from miscellaneous operations.
- 535. Taxes on miscellaneous operating property.
- Miscellaneous operating income.
- Total operating income.

II. Non-operating Income—

- 503. Hire of freight cars—Credit balance.
- 504. Rent from locomotives.
- 505. Rent from passenger-train cars.
- 506. Rent from floating equipment.
- 507. Rent from work equipment.
- 508. Joint facility rent income.
- 509. Income from lease of road.

*Includes operations of water lines, if any.

- 510. Miscellaneous rent income.
- 511. Miscellaneous non-operating physical property.
- 512. Separately operated properties—Profit.
- 513. Dividend income.
- 514. Income from funded securities.
- 515. Income from unfunded securities and accounts.
- 516. Income from sinking and other reserve funds.
- 517. Release of premiums on funded debt.
- 518. Contributions from other companies.
- 519. Miscellaneous income.
- Total non-operating income.
- Gross income (or loss).

III. Deductions from gross income:

- 536. Hire of freight cars—Debit balance.
- 537. Rent for locomotives.
- 538. Rent for passenger-train cars.
- 539. Rent for floating equipment.
- 540. Rent for work equipment.
- 541. Joint facility rents.
- 542. Rent for leased roads.
- 543. Miscellaneous rents.
- 544. Miscellaneous tax accruals.
- 545. Separately operated properties—Loss.
- 546. Interest on funded debt.
- 90 547. Interest on unfunded debt.
- 548. Amortization of discount on funded debt.
- 549. Maintenance of investment organization.
- 550. Income transferred to other companies.
- 551. Miscellaneous income charges.
- Total deductions from gross income.
- Net income (or loss).

IV. Disposition of Net Income:

- 552. Income applied to sinking and other reserve funds.
- 553. Dividend appropriations of income.
- 554. Income appropriated for investment in physical property.
- 555. Stock discount extinguished through income.
- 556. Miscellaneous appropriations of income.
- Total appropriations.
- Income balance transferred to credit (or debit) of Profit and Loss.

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Affidavit of J. C. Nelms, Jr.

Filed June 20, 1922.

In the United States District Court, Eastern District of North Carolina.

In Equity.

NORFOLK SOUTHERN RAILROAD COMPANY

vs.

A. D. WATTS et al.

Affidavit of J. C. Nelms, Jr.

J. C. Nelms, Jr., being first duly sworn, deposes and says: that: Accompanying and constituting a part of the order of the Interstate Commerce Commission, made the 19th of May, 1914, effective July 1st, 1914, and still in force, with such modifications and amendments as may have been made thereto, were certain special instructions of which No. 1 reads as follows:

"Income accounts are those designed to show, as nearly as practicable, for each fiscal period, the total amount of money that a carrier becomes entitled to receive for services rendered, the returns accrued upon investments, the accrued costs paid or payable for the services rendered by it, the losses sustained by it, the amounts accrued for taxes, for use of moneys and for use of properties of others, and the appropriations made from income during the period. The net balance of income (or loss) shall be carried to Profit and Loss."

The order above referred to is the order of the Commission regulating the keeping of records by Interstate Carriers by Railroad, known as "Classification of Income, Profit and Loss, and General Balance Sheet Accounts for Steam Roads."

J. C. NELMS, JR.

Sworn and subscribed to before me this 12th day of June, 1922.

GILBERT C. REVEILLE,
Notary Public.

My commission expires the 31st day of August, 1924.

92 *Testimony of R. O. Self at Hearing Before Judge Connor.*

It is agreed that all affidavits filed in the cause by either of the plaintiffs or by the defendants will be treated as in evidence in all cases.

Mr. R. O. Self, Clerk of the North Carolina Corporation Commission produced a list of the corporations operating as limited common

carriers in North Carolina under authority granted by the State Corporation Commission under section 3413 of the Consolidated Statutes of North Carolina. Also a memorandum adding two other roads was attached, all filed as Exhibit A.

R. O. SELF, witness for the defendant, examined by Judge Manning, testifies as follows:

That the several roads mentioned in Exhibit A were lumber roads, for logging purposes, operating under Section 3413 of the Consolidated Statutes as a limited carrier, with the right to stop at anytime.

93 EXHIBIT "A" TO TESTIMONY OF R. O. SELF.

Office of the Corporation Commission.

STATE OF NORTH CAROLINA:

This is to certify, that the Corporation Commission of North Carolina, acting under power vested in it by Sec. 3413 of the Consolidated Statutes of North Carolina, has granted authority to the corporations named below to conduct and carry on the business of limited common carriers between the points designated as to each of the corporations named, and that said corporations have filed with the Corporation Commission of North Carolina tariffs establishing the rate of charges which they are authorized to make for the transportation of commodities between the points named.

The corporations named and the points between which they are authorized to act as limited common carriers, engaged in Intrastate Commerce in North Carolina over a line of steam railroad, are as follows:

Andrews Manufacturing Company, Between Andrews and Old Road Gap, a distance of 8 miles, of thereabouts.

Carr Lumber Company, Between Pisgah Forest and Vanderbilt Boundary, a distance of about 20 miles.

Empire Manufacturing Company, Between Oliver Station to within three miles of Bentonville, about 13 miles.

Enterprise Lumber Company, Between Mount Olive and New Camp, a distance of 18 miles, or thereabouts.

Fishing Creek Timber & Railroad Company, Between Stamper, N. C., and Coffield's Bridge, about 10 miles.

Carolina Southern Railroad, Between Hollister and Vaughan, a distance of 14½ miles, or thereabouts.

Montgomery Lumber Company, Between Spring Hope and Bunn, N. C., a distance of 10 miles or thereabouts.

94 Ocono Luffy Railroad Company, Between Ocono Luffy, N. C., and Smokemont, N. C., about 10 miles.

Rowland Lumber Company, Between Bowdens, N. C., and Warsaw, N. C., toward Newton Grove, a distance of about 20 miles.

Waccamew Lumber Company, Between Bolton and Makatoka, a distance of about 18 miles.

Weldon Lumber Company, Between Weldon, N. C., and a point near Ringwood, a distance of about 20 miles.

Whiteville Lumber Company, Between Whiteville, N. C., and Buttler, a distance of about 27 miles.

Mill Creek Valley Railroad Between — and — a distance of about — miles.

Suncrest Lumber Co., Sunburst to Canton.

Hilton Railroad & Logging Co., Hilton Creek to Island Creek, 6 miles.

Done at the office of the Corporation Commission, at Raleigh, on this the — day of May 1922, by the Corporation Commission, through W. T. Lee, its Chairman, and under the seal of the said Commission.

95 *Testimony of C. J. Joseph at Hearing Before Judge Connor.*

C. J. Joseph, Tax Agent of the A. C. L. Railroad, witness for the Plaintiff, examined by Mr. Thomas W. Davis, testifies as follows:

That he had for a great many years been the tax agent of that road, with the duty of checking and looking after all the taxes of that Company and its affiliated lines in Virginia, North and South Carolina, Georgia, Florida and Alabama. That he was familiar with this litigation and with the Income Tax Laws of North Carolina: that he has to keep up with the stocks and bonds and statistics of the various roads mentioned: that he is familiar with the commercial and financial Chronicle, a financial trade paper, circulated throughout the United States, that collects roads and industrial corporations and their stocks and bonds. The issue of May 27, 1922, of that paper was offered in evidence, and Mr. Davis desired to read into the record the capital stock and bonds of certain industrial corporations reporting to the North Carolina Tax Commission, the Tax Commission showing the capital, but not the bonds issued by them.

96 EXHIBIT TO TESTIMONY OF C. J. JOSEPH.

Representative Partial List of Industrial Corporations Doing Business in North Carolina and Reporting to the North Carolina Corporation Commission and Commissioner of Revenue Financed by Bonds and Stocks.

American Agricultural Chemical Company:

Common stock	\$33,322,126
Preferred Stock	28,455,200
First Mortgage bonds	6,252,000
1st Ref. Mortgage s. f. gold bonds, Series "A" ..	30,000,000

American Sugar Refining Company:

Common Stock	45,000,000
Preferred Stock	45,000,000
15 Year Gold Bonds	30,000,000

American Tobacco Company:

Common Stock "A"	40,242,400
Common Stock "B"	49,344,200
Preferred Stock	52,699,700
Gold Bonds	371,950
Gold Bonds & Cons, Tobacco Collateral Trust	
Trust Mortgage Bonds	1,365,300
Series of Gold Notes	10,000,000
8% Dividend Certificates	8,058,834

Dupont, I. E., de Nemours & Company:

Common stock	63,378,300
Debenture Stock	71,243,250
10 Year Gold Bonds	35,000,000

Galena Signal Oil Company:

Common Stock	16,000,000
Preferred Stock	2,000,000
New Preferred Stock	4,000,000
Convertible Debenture	6,000,000
Entire Stock of Subsidiary Companies	2,800,000
Galena Signal Oil of Texas Bonds	2,800,000

General Electric Company:

Common Stock	176,329,100
Debenture for Sprague Stock	2,047,000
Debenture	15,136,500
Debenture Bonds	15,000,000

Kelly Springfield Tire Company:

Common Stock	9,096,000
Preferred Stock	3,137,100
Second Preferred	5,625,200
10 Year s. f. Gold Notes	10,000,000

97 Morris Company:

1st Mortgage	\$17,626,000
10 Year s. f. Gold Notes	15,000,000
Wm. F. Mosser Co. 10 yr. s. f. notes	3,000,000

Swift & Company:

Common Stock	150,000,000
1st Mortgage s. f. Gold Bonds	28,923,500
Gold Notes	65,000,000

Texas Company:

Stock	164,450,000
3 yr. S. F. Notes	22,772,000

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Final Decree.

Filed Nov. 13, 1922.

In the District Court of the United States for the Eastern District of
North Carolina, Raleigh Division.

Equity, No. 450.

NORFOLK SOUTHERN RAILROAD COMPANY

vs.

A. D. WATTS and A. D. WATTS, as Commissioner of Revenue, and
JAMES S. MANNING, Attorney General of North Carolina.

Decree.

This is a suit in equity, brought by plaintiff, Norfolk Southern Railroad Company, a corporation chartered and organized under the laws of the State of Virginia, operating a line of railway in and through the State of North Carolina and the Eastern District thereof, against defendant, A. D. Watts, individually, and as Commissioner of Revenue of North Carolina and James S. Manning, Attorney General of said State, seeking an injunction restraining and enjoining said defendants from taking or causing to be taken any action toward enforcing the filing of a return or the collection of a tax or any part thereof, imposed, or sought to be imposed by the State of North Carolina, upon the plaintiff, under or by virtue of the provisions of the Public Laws of North Carolina of 1921, Chapter 34, known as the Revenue Act or the Income Tax Act, as amended by the General Assembly of North Carolina at its Special Session of 1921.

Following the service of process on the defendants and filing answer to the bill, the cause was set down for hearing upon the bill, answer and evidence.

Plaintiff alleges that, by the provisions of Article 5, Section 3 of the Constitution of North Carolina, the General Assembly is authorized to pass laws.

"Taxing, by a uniform rule, all moneys, credits, investments in bonds, stocks, joint-stock companies, or otherwise, and also real and personal property, according to its true value in money. * * *

The General Assembly may also tax trades, professions and incomes.

99 Provided the rate of tax on incomes shall not, in any case, exceed six per cent, and there shall be allowed the following exemptions, to be deducted from the amount of annual incomes to-wit: For a married man, with a wife living with him, or to a widow or widower having minor child or children, natural or adopted, not less than \$2,000.00; to all other persons not less than \$1,000; and there may be allowed other deductions (not including living expenses), so that only net incomes are taxed."

Pursuant to the provisions of the foregoing Art. of the Constitution, the General Assembly, at its Session of 1921, enacted a statute providing for levying, collecting and paying an income tax on individuals and corporations. Chap. 34 Public Laws of North Carolina and known as a part of the Revenue Act of 1921, or, so far as it relates to the Income Tax, as the "Income Tax Act of 1921."

The sections of this Act pertinent to the questions presented for decision by the plaintiff's contention are:

Section 101. Purpose.—

"The general purpose of this act is to impose a tax for use of the State Government, upon the net income for the calendar year 1921, in excess of exemptions herein set out, collectible in the year 1922 and annually thereafter:

(a) Of every citizen of the State.

(b) Of every domestic corporation.

(c) Of every foreign corporation and of every non resident individual having a business or agency in this State in proportion to the net income of such business or agency.

"Except as otherwise provided in this Act, the purpose is to conform to the definitions of income in the revenue laws of the United States Government and regulations made under its authority in so far as they apply."

"The tax imposed upon the net income of corporations in this Schedule is in addition to the tax imposed under Schedule "C" of this Act."

Section 201. Corporations.—

Every corporation organized under the laws of this State shall pay annually an income tax equivalent to three per cent of the entire net income of such corporation, as herein defined, received by such corporation during the income year; and every foreign corporation doing business in this State shall pay annually an income tax equivalent to three per cent of a proportion of its entire net income, to be determined according to the following rules.

In case of a Company other than Companies mentioned in the next succeeding section, deriving profits principally from the ownership, sale or rental of real estate or from the manufacture, sale or use of tangible personal property, such proportion of its entire net income as the fair cash value of its real estate and tangible personal property, in this State, on the date of the close of the fiscal year of such Company in the income year is to be the fair cash value of its entire real estate and tangible personal property then owned by it, with no deduction on account of incumbrances thereon.

In case of a corporation deriving profits principally from the holding or sale of intangible property such proportion as its gross receipts in this State for the year ended on the date of the close of

its fiscal year next preceding is to its gross receipts for such year within and without the State.

"Section 202. Railroads and public service corporations.—

"The basis of ascertaining the net income of every corporation engaged in the business of operating a steam or electric railroad, express service, telephone or telegraph business, or other form of public service, when such company is required to keep records according to the Standard Classification of Accounting of the Interstate Commerce Commission, shall be the 'net operating income' of such corporations as shown by their records kept in accordance with that Standard Classification of Accounts, when their business is wholly within this State and when their business is in part within and in part without this State, including in their gross 'operating revenues' within this State the equal mileage proportion within this State of their interstate business and deducting from their gross 'operating revenues' the proportionate average of operating expenses' or 'operating ratio', for their whole business, as shown by the Interstate Commerce Commission Standard Classification of Accounts. From the net operating income thus ascertained shall be deducted 'uncollectible revenue' and taxes paid in this State for the income year, other than income taxes and war profits and excess profits taxes, and the balance shall be deemed to be their net income taxable under this Act."

The foregoing section relating to the basis of ascertaining the net income of railroads was supplemented by Chapter 35 of the Public Laws of 1921, as follows:

"Sec. 1. That in determining the taxable income of a corporation engaged in the business of operating a railroad under section two hundred and two of the act to raise revenue, in the case of a railroad located entirely within this State, the net operating income shall be increased or decreased to the extent of any credit or debit balance received or paid, as the case may be, on account of car hire; and when any railroad is located partly within and partly without this State, then said net operating income shall be increased or decreased to the extent of an equal mileage proportion within this State of any credit or debit balance received or paid, as the case may be, on account of car hire."

101 Section 203 of the Income Tax Act of 1921, as amended by Chapter 35, Public Laws of 1921, is as follows:

"Section 203. Such tax shall first be levied, collected and paid in the year 1922, and with respect to the net income received during the calendar year 1921, and annually thereafter."

Section 3 of Chapter 34, Public Laws of 1921, provides:

"No tax on any property in the State shall be levied for any of the uses of the State Government. The taxes hereinafter levied in

this act are for the expenses of the State Government, the appropriations to its educational, charitable and penal institutions, pensions for Confederate Soldiers and widows, the interest on the debt of the State, an equalizing fund for public schools, and other specific appropriations made by law, and shall be collected and paid into the general fund of the State Treasurer."

"Section 306. Deductions.—

"In computing net income there shall be allowed as deductions:

"1. All the ordinary and necessary expenses paid during the income year in carrying on any trade or business, including:

"(a) As to individuals, wages of employees for services actually rendered in producing such income.

"(b) As to partnerships, wages of employees and a reasonable allowance for co-partners or members of a firm, for services actually rendered in producing such income, the amount of such salary allowance to be included in the personal return of the co-partner receiving same.

"(c) As to corporations, wages of employees and salaries of officers, if reasonable in amount, for services actually rendered in producing such income.

"2. Rentals or other payments required to be made as a condition of the continued use or possession, for the purposes of the trade of property to which the taxpayer has not taken or is not taking title or in which he has no equity.

"3. All interest paid during the income year on indebtedness except interest on obligations contracted for the purchase of non-taxable securities. Dividends on preferred stock shall not be deducted as interest.

"4. Taxes for the income year, except taxes on income and war profits, and excess profits taxes, inheritance taxes, and taxes assessed for local benefit of a kind tending to increase the value of the property assessed.

102 "5. Dividends from stock in any corporation the income of which shall have been assessed and the tax on such income paid by the corporation under the provisions of this Act: Provided, that when only part of the income of any corporation shall have been assessed under this act, only a corresponding part of the dividends received therefrom shall be deducted.

"6. Losses sustained during the income year and not compensated for by insurance or otherwise, if incurred in any transaction entered into for profit.

"7. Debts ascertained to be worthless and charged off within the income year, if the amount has previously been included in gross income in a return under this act.

"8. A reasonable allowance for the depreciation and obsolescence of property used in the trade or business; and, in the case of mines, oil and gas wells, other natural deposits, and timber, a reasonable allowance for depletion: Provided, that in computing the deductions allowed under this paragraph, the basis shall be the cost (including in the case of mines, oil and gas wells, and other natural deposits, the cost of development, not otherwise determined) and in the case of property acquired prior to January 1, 1921, the fair market value of the property (or the taxpayer's interest therein) on that date shall be taken in lieu of cost up to that date. The reasonable allowances under this paragraph shall be made under rules and regulations to be prescribed by the Tax Commission. In the case of leases the deductions allowed may be equitably apportioned between the lessor and lessee.

"9. In the case of taxpayers who keep regular books of account, upon an accrual basis and in accordance with standard accounting practice, reserves for bad debts and for contingent liabilities, under such rules and restrictions as the Tax Commission may impose. If the Tax Commission shall, at any time, deem the reserve excessive in amount, it may restore such excess to income, either in a subsequent year or as a part of the income of the income year and assess it accordingly.

"10. Contributions or gifts made within the taxable year to corporations or associations operated exclusively for religious, charitable, scientific or educational purposes, or for the prevention of cruelty to children or animals, no part of the net earnings of which enures to the benefit of any private stockholder or individual, to an amount not in excess of fifteen per centum of the taxpayer's net income as computed without the benefit of this subdivision.

"11. Resident individuals having an established business in another State, or investment in property in another State, may deduct the net income from such business or investment, if such business or investment is in a State that levies a tax upon such net income. The deductions authorized in this subsection shall in no case extend to any part of income or resident individuals from personal services or mortgages, stocks, bonds, securities and deposits.

103 "12. In the case of a non-resident individual, the deductions allowed in this section shall be allowed only if, and to the extent that, they are connected with income arising from sources within the State; and the proper apportionment and allocation of the deductions with respect to sources of income within and without the State shall be determined under rules and regulations prescribed by the State Tax Commission.

Complainant is engaged in operating an interstate railroad and keeps its accounts in accordance with the Standard Classification of Accounts prescribed by the Interstate Commerce Commission and is required to pay an income tax under the appropriate part of Section

202 of the Income Tax Act or suffer the penalties prescribed in said Act.

Complainant respectfully shows the Court that the said Act is void as to complainant for the following reasons:

(a) Article 5, Section 3 of the Constitution of North Carolina authorizes the levy of a tax upon net incomes, and the statutory method prescribed in Section 202 for complainant and like corporations in order to arrive at net income results in the tax being levied on a sum which is not in truth and in fact net income, but includes a part of complainant's operating revenue in this:

Section 202 provides that railway corporations in the class of complainant shall first arrive at gross operating revenue within the State of its interstate business, and from this gross revenue shall deduct the following items:

(1) Proportionate average of operating expenses, as shown by the Interstate Commerce Commission Standard Classification of Accounts.

(2) Uncollectible revenue.

(3) Taxes paid in North Carolina for the income year, other than taxes and war profits and excess profits taxes.

(4) An equal proportion of car hire.

Plaintiff alleges that defendants, unless restrained by order of this Court, will, pursuant to the provisions of the Statutes in force in the State of North Carolina, levy upon and assess against it the income taxes for the year 1922 and certify such levy and assessment to the officers charged with the enforcement and collection thereof, amounting to a large sum in excess of \$3,000.00 to-wit, the sum of \$19,616.46, whereas plaintiff avers that if it is allowed the deductions to which it is entitled it would not have any taxable income because the sum of such deductions is greater than its gross income, and that unless said taxes are paid within the time fixed by the Statute, plaintiff will be subjected to heavy penalties and that the levy of such taxes will constitute a lien upon its property and thereby a cloud upon its title thereto, and that plaintiff will suffer other and irreparable damage, etc., all of which will appear by reference

104 to the allegations set out in its bill herein. The plaintiff's bill seeking an injunction, restraining defendants in the discharge of the official duties imposed by the Statute is based upon the allegation that the sections of the Revenue Act of 1921, and especially upon those sections known as the "Income Tax Act" violate the Constitution of the State of North Carolina and of the United States for that among other reasons:

1st. The tax levied as directed by said Statute is not a tax on net incomes but is levied upon gross income, or real net operating income and hence is repugnant to the State Constitution and to the Commerce Clause of the Federal Constitution.

2nd. The classification made by Section 202 of the Act as to method of ascertainment of net income for plaintiff and other corporations within the designed class is arbitrary, without reasonable or practical basis and hence is repugnant to the Uniformity Clause, Art. 5, Sec. 3 of the State Constitution and the Equal Protection Clause of the Fourteenth Amendment to the Constitution of the United States.

That it is a violation of the State Constitution for the general property tax to be devoted to local purposes and the various exercise, privilege, franchise, license, and income taxes to be devoted to State purposes.

That the income tax is invalid because it is levied in addition to property and franchise taxes. That the method of ascertaining the taxable income of plaintiff fixed or prescribed by Sec. 202 of the Act violates the provisions of Art. 5, Sec. 3 of the State Constitution and of the Fourteenth Amendment to the Federal Constitution, for that such method is not applied to such railroads or other public service corporation which do not operate their properties but have income only from rentals paid them by other companies to whom they lease their entire properties to be operated by the lessees.

It is pertinent, in view of the questions presented by the bills and answers and the prayer for injunctive relief to note the provisions of Section 700-701 of the Income Tax Act as amended by the Act of 1921, creating the office known as Commissioner of Revenue, providing for the prescribing the procedure in applications for revision and appeal from assessments and levies of taxes against all persons or corporations having property in, or being liable for, tax in the State.

The Legislature, at its Special Session of 1921, made further provisions for refunding any taxes of any kind which have been through clerical error or misinterpretation or otherwise, collected or paid into the State Treasury in excess of the amount legally due the State and directing the State Auditor to issue his warrant for the amount so illegally collected to the person entitled thereto, upon certificate of the head of the department through which said taxes were collected

105 or his successor in the performance of the functions of that department, with the approval of the Attorney General and the Treasurer to pay the sum out of any funds in the treasury not otherwise appropriated.

Upon consideration of the bill and answer, Exhibits and evidence, it is

Adjudged and decreed that plaintiff is not entitled to have the defendants or either of them enjoined and restrained from the performance of the duties imposed upon them by the Statutes of North Carolina, relating to the administration, assessing, levying and enforcement or collection of the income tax against plaintiff. That the bill be dismissed. That defendants recover their cost to be taxed by the Clerk.

This the 7th day of November, 1922.

At Wilson, N. C.

H. G. CONNOR,

U. S. District Judge.

106

Notice of Appeal.

Filed Nov. 16, 1922.

In the District Court of the United States for the Eastern District of
North Carolina.

In Equity.

No. 450.

NORFOLK SOUTHERN RAILROAD COMPANY, Plaintiff,

vs.

A. D. WATTS, Commissioner of Revenue of North Carolina, et al.,
Defendants.

Notice of Appeal.

To the defendants in the above-entitled action and Honorable James
S. Manning, Attorney General of North Carolina, and Frank Nash,
Assistant Attorney General, Solicitors for defendants:

You will please take notice that, on Friday, November 17th, 1922,
at 10.00 o'clock A. M., or as soon thereafter as counsel may be heard,
the above named plaintiff will apply to his Honor, Henry G. Connor,
District Judge, at the United States Court Room, Wilmington, N. C.,
for an order allowing plaintiff to appeal to the Supreme Court in
the above cause, and granting a stay of proceedings until the appeal
shall have been heard, passed upon *the* disposed of by the Supreme
Court of the United States.

NORFOLK SOUTHERN RAILROAD
COMPANY,

By W. B. RODMAN,
Solicitor.

Service accepted this 16th day of November.

JAMES S. MANNING,
*Attorney General of North Carolina
and Solicitor for Defendants.*

107

Order Granting Thirty Day Stay.

Filed Nov. 18, 1922.

In the District Court of the United States for the Eastern District of North Carolina.

In Equity.

No. 450.

NORFOLK SOUTHERN RAILROAD COMPANY

vs.

A. D. WATTS, as Commissioner of Revenue of North Carolina, and Others.

Income Tax Suit.

It is ordered that the defendants shall not proceed to enforce the collection of taxes involved in this litigation for the period of thirty days from the date of this order, to the end that complainant may take such action in the premises as it is advised to.

Dated at Wilmington, North Carolina this the 17th day of November, 1922.
H. G. CONNOR,
U. S. Judge.

108

Assignment of Errors.

Filed Nov. 27, 1922.

In the District Court of the United States for the Eastern District of North Carolina.

NORFOLK SOUTHERN RAILROAD COMPANY, Plaintiff,

vs.

A. D. WATTS, Commissioner of Revenue, and JAMES S. MANNING, Attorney General for the State of North Carolina, Defendants.

Assignment of Errors.

The plaintiff prays an appeal from the final decree of this Court, to the Supreme Court of the United States, and assigns for error:

(1) That Schedule "D" of the said Act of the General Assembly of the State of North Carolina, Chapter 34 Public Laws of 1921, being an act entitled "An Act to Raise Revenue" ratified the 8th day of March, 1921, and the amendments and supplements thereto, and especially the said act as amended by Chapter 102 of the Pub-

lie Laws of the Extra Session, 1921, ratified the 19th day of December, 1921, and entitled "An Act to Amend Chapter 34 of the Public Laws of 1921, being an Act to Raise Revenue, relative to privilege tax and the Income Tax on Railroads," is in contravention of the Constitution of the United States, especially of the interstate commerce clause, section 8, article I; of section 2 article IV; of Section 1 article XIV.

(2) That the said Act is in contravention of the Constitution of the State of North Carolina, especially of section 3 article V.

(3) That said Act does not provide a method for the taxation of income of the complainant as required by the Constitution of the State, or by uniform rule as compared with the income of
109 other citizens, residents, persons or corporations doing business in the State of North Carolina, and subject to an income tax, but is really an attempt to enforce against Norfolk Southern Railroad Company and other interstate carriers in the State of North Carolina and of the United States, engaged in interstate commerce, the payment of a tax on account of and for the reason that this plaintiff, and other companies similarly situated, are engaged in the business of conducting and carrying on interstate commerce by attempting through an unjust, unreasonable and illegal classification to require plaintiff and other railroad companies doing business in the State of North Carolina and engaged in interstate commerce, to pay an income tax upon more than their net income, while all other tax payers are taxed upon their net income.

(4) That the assessment for income tax made by the defendant A. D. Watts, as Commissioner of Revenue, against the plaintiff was not made upon the net income of this plaintiff, but was made upon what was termed its "net operating income," while all other individuals and corporations doing business in the State of North Carolina and subject to income tax had their income tax assessed upon the basis of their net income, except corporations engaged in the business of operating steam or electric railroads, express service, telephone or telegraph business, or other form of public service, when such company is required to keep records according to the Standard Classification of Accounting of the Interstate Commerce Commission.

That the said assessment of the income tax made by the defendant A. D. Watts, as Commissioner of Revenue of North Carolina
110 was illegal and void, as being made upon a classification of plaintiff and other public service corporations engaged in interstate commerce and required to report to the Interstate Commerce Commission, and to keep their records in accordance with the orders of that Commission, and thereby imposed, or undertook to impose a tax upon the plaintiff by reason of the fact that it was engaged in interstate commerce, which tax is greater than would be imposed upon plaintiff if it were not engaged in such interstate commerce, and undertook to classify, for the purpose of an income tax and of

ascertaining what constituted net income, taxpayers into two classes, to-wit: Those engaged in interstate commerce in the operation of public service, as common carriers, and all other tax payers in the other class. That such classification was and is in violation and contravention of the Constitution of the United States, especially of the interstate commerce clause of section 8 article I; of section 2 article IV and of section 1 article XIV, and is in violation and in contravention of the Constitution of the State of North Carolina, especially section 3 article V thereof.

(5) That the Court erred in holding that the United States District Court was without jurisdiction to hear and determine the questions raised by the bill and answer filed in this cause.

(6) That the court erred in holding that the plaintiff was not entitled to have the defendants, or either of them, enjoined or restrained from the performance of the duties imposed upon them by the statutes of North Carolina, relative to the administration, assessing, levying and enforcement of collection of the income tax against plaintiff, and in dismissing the bill.

111 (7) That the court erred in refusing to enjoin the defendants from undertaking to enforce the collection of the assessment of income tax against the plaintiff, as made by A. D. Watts, Commissioner of Revenue.

W. B. RODMAN,
Attorneys for Plaintiff.

112 *Stipulation of Counsel as to the Record.*

Filed Dec. 2nd, 1922.

In the District Court of the United States for the Eastern District of North Carolina.

In Equity.

NORFOLK SOUTHERN RAILROAD COMPANY, Plaintiff,

vs.

A. D. WATTS, Commissioner of Revenue, and JAMES S. MANNING,
Attorney General of State of North Carolina, Defendants.

It is stipulated and agreed by and between the parties to the above entitled cause that, the Clerk in making up transcript of record in this appeal on the order dismissing plaintiff's appeal and denying the injunction prayed for shall include all pleadings, orders, motions, stipulations, affidavits and exhibits constituting the entire record before the Court.

It is further stipulated that the Clerk shall use in preparing record on appeal printed copies of all such pleadings, documents, affidavits, etc. as may be furnished by the parties hereto.

W. B. RODMAN,
Solicitor for Plaintiff.
GEO. H. BROWN,
Of Counsel for Defendants.

28 day of Novb., 1922.

113 *Memorandum of Original Papers Certified Separately.*

Petition for Appeal filed November 27, 1922.

Appeal allowed Nov. 27, 1922.

Appeal Bond dated 1, 1922; penalty \$1,000.00; Obligors: Norfolk Southern Railroad Company and United States Fidelity and Guaranty Company; Conditioned for damages and costs.

Citation dated Nov. 27, 1922; service accepted by Geo. H. Brown, of Counsel for defendants, Nov. 27, 1922.

114 *Order to Transmit Record.*

In the District Court of the United States for the Eastern District of North Carolina.

In Equity.

No. 450.

NORFOLK SOUTHERN RAILROAD COMPANY

vs.

A. D. WATTS, Commissioner of Revenue, et als.

And thereupon it is ordered by the Court here that a transcript of the record and proceedings in said suit be transmitted to the United States Supreme Court at Washington, D. C., and the same be transmitted accordingly.

S. A. ASHE,
Clerk United States District Court.

115

Clerk's Certificate.

In the District Court of the United States for the Eastern District of North Carolina.

In Equity.

No. 450.

NORFOLK SOUTHERN RAILROAD COMPANY

vs.

A. D. WATTS, Commissioner of Revenue, et als.

I, S. A. Ashe, Clerk, United States District Court, for the Eastern District of North Carolina, do hereby certify that the foregoing pages present a full, true and correct copy of the proceedings had and orders entered in that certain suit in equity pending in said Court, wherein Norfolk Southern Railroad Company is complainant and A. D. Watts, Commissioner of Revenue of North Carolina, and others, are defendants.

In testimony whereof, I have hereunto set my hand and affixed the seal of the said District Court at the Courthouse in Raleigh, State of North Carolina, this 9th day of December, 1922.

[Seal United States District Court, Eastern Dist. of N. C. at Raleigh.]

S. A. ASHE,

Clerk United States District Court.

116 In the District Court of the United States for the Eastern District of North Carolina.

NORFOLK SOUTHERN RAILROAD COMPANY, Plaintiff,

vs.

A. D. WATTS, Commissioner of Revenue, and JAMES S. MANNING, Attorney General of State of North Carolina, Defendants.

The above named plaintiff conceiving itself aggrieved by the decree dated the 7th day of November, 1922, made and entered on the 13th day of November, 1922, in the above entitled cause, does hereby appeal from said order and decree to the Supreme Court of the United States, for the reasons specified in the assignment of errors which is filed herewith, and prays that this appeal may be allowed, and that a transcript of the record, proceedings and papers upon which said order was made, duly authenticated, may be sent to the Supreme Court of the United States.

In connection with said appeal, the above named plaintiff respectfully prays the Court that it enter an order staying the hands of the defendants from collecting or attempting to collect, pending the hearing and disposal of said appeal, the taxes referred to and described in the bill filed in this cause, and which are alleged therein to be illegal and void, in that they are laid and attempted to be collected in violation of the provisions of the Constitution of the United States, and in support of said request and prayer for such stay, respectfully shows to the Court that the only way this plaintiff can have its appeal passed on and heard by the appellate court is by a stay of the hands of the defendants in their attempt to collect the said taxes, pending the appeal, that the very moment the said taxes are paid, the questions presented become moot questions and the appellate court will be deprived of its jurisdiction to hear and pass on the questions involved.

W. B. RODMAN,
Attorneys for Plaintiff.

Dated this 27th day of November, 1922.

118 [Endorsed:] #450. Equity. Norfolk Southern Railroad Co. vs. A. D. Watts et al. Petition for appeal. I certify that the within is entered and filed this day, Nov. 27, 1922. S. A. Ashe, Clerk.

119 In the District Court of the United States for the Eastern District of North Carolina.

In Equity.

No. 450.

NORFOLK SOUTHERN RAILROAD COMPANY, Plaintiff,

vs.

A. D. WATTS, Commissioner of Revenue of North Carolina, et al.,
Defendants.

Order Allowing Appeal and Granting Supersedeas and Stay.

This cause coming on to be heard upon the application of plaintiff, Norfolk Southern Railroad Company, for an appeal to the Supreme Court of the United States, and for a supersedeas and order staying and restraining the collection of the income tax involved in this suit and alleged to be illegal in the complaint filed herein, until the determination of the appeal in this cause now pending in the Supreme Court of the United States, the plaintiff being represented by W. B. Rodman, its attorney, and the defendants by their attorneys, Frank Nash, Assistant Attorney General, and George H. Brown, the appeal prayed for is hereby granted, Appeal Bond in the sum of \$1,000.00 to be filed.

And the Court being of the opinion that the status quo between the parties should be preserved pending such determination of appeal by the plaintiff to the Supreme Court of the United States:

It is therefore, decreed and adjudged that defendants, their agents, servants and employees and each of them be and are hereby restrained from collection or attempting to collect from plaintiff the income tax which is the subject matter of this suit, pending the determination of the appeal by the plaintiff in this cause now pending in the United States Supreme Court.

It is further ordered and decreed that plaintiff do give bond with good and sufficient surety, in the sum of Ten Thousand Dollars, to be approved by the Judge of the United States Court for the Eastern District of North Carolina, or the Clerk of said Court, conditioned to pay to said defendants all of such income tax that may finally be determined in this cause to be legally due and payable by plaintiff to the defendants.

Dated this 27th day of November, 1922.

H. G. CONNOR,

District Judge Eastern District of North Carolina.

120 & 121 [Endorsed:] J. #450. Eq. Norfolk Southern Railroad Co. vs. A. D. Watts et —. Appeal & Granting Order allowing Supersedeas & Stay under \$10,000 Bond. I certify that the within is entered and filed this day. Nov. 27, 1922. S. A. Ashe, Clerk.

122 In the District Court of the United States for the Eastern District of North Carolina.

In Equity.

NORFOLK SOUTHERN RAILROAD COMPANY, Plaintiff,

vs.

A. D. WATTS, Commissioner of Revenue of North Carolina, and James S. Manning, Attorney General of North Carolina, Defendants.

Know all men by these presents: That we, Norfolk Southern Railroad Company, a corporation organized and existing under the laws of the State of Virginia, as principal, and United States Fidelity and Guaranty Company, as surety, are held and firmly bound unto the above named A. D. Watts, and the other defendants, in the sum of One Thousand Dollars (\$1,000.00), to be paid to the said A. D. Watts and the other defendants, their successors and assigns, to which payment, well and truly to be made, we bind ourselves and our successors jointly and severally by these presents.

Sealed with our seals this 1st day of December, 1922.

Whereas, in a suit pending in the District Court of the United States for the Eastern District of North Carolina between Norfolk Southern Railroad Company, Plaintiff, and A. D. Watts, and other defendants, a decree was rendered by said Court, denying plaintiff an

injunction as prayed for and dismissing plaintiff's bill, and the said Norfolk Southern Railroad Company having prayed and been allowed an appeal under Section 238 of the Judicial Code of the United States direct to the Supreme Court of the United States, and filed a copy thereof in the Clerk's office of the said Court, and
 123 & 124 citation having issued to said A. D. Watts, et al., citing and admonishing them to be and appear in the Supreme Court of the United States within the time required by law.

Now, the condition of the above obligation is such, that if the said Norfolk Southern Railroad Company shall prosecute its said appeal to effect, and answer all damages and costs if it fails to make its appeal good, then the above obligation shall be void, else to remain in full force and effect.

NORFOLK SOUTHERN RAILROAD
 COMPANY,

Attest: By G. R. LOYALL, *President.*

[Seal of the Norfolk Southern Railroad Company, Virginia.]

W. HAWKINS,
Secretary.

[Seal of the United States Fidelity & Guaranty Company, Incorporated 1896.]

UNITED STATES FIDELITY AND
 GUARANTY COMPANY,
 By MARGARET W. WALKER,
Attorney in Fact.

Approved this 2 day of December, 1922.

H. G. CONNOR,
United States District Judge.

125 [Endorsed:] #450. Equity. Norfolk Southern Railroad Co. vs. A. D. Watts et al. \$1,000.00 Appeal Bond. I certify that the within is entered and filed this day, Dec. 2, 1922. S. A. Ashe, Clerk.

126 In the District Court of the United States for the Eastern District of North Carolina.

NORFOLK SOUTHERN RAILROAD COMPANY, Plaintiff,

vs.

A. D. WATTS, Commissioner of Revenue, and JAMES S. MANNING, Attorney General for the State of North Carolina, Defendants.

The United States of America to A. D. Watts, as Commissioner of Revenue of North Carolina, and James S. Manning, as Attorney General of North Carolina, Greeting:

Whereas, Norfolk Southern Railroad Company has lately appealed to the Supreme Court of the United States, from a decree lately ren-

dered in the District Court of the United States for the Eastern District of North Carolina, made in favor of you, the said Norfolk Southern Railroad Company having filed the security required by law, you are therefore hereby cited to appear before the said Supreme Court at the City of Washington on the 27 day of December next, to do and receive what may appertain to justice to be done in the premises.

Given under my hand at the City of Raleigh in the Fourth Circuit, this the 27 day of November, in the year of our Lord, One Thousand Nine Hundred and Twenty-two.

H. G. CONNOR,
*Judge of the District Court of the United
States for the Eastern District of North
Carolina.*

I certify that the within is entered and filed this day Nov. 27, 1922.
S. A. ASHE,
Clerk.

Service accepted this Nov. 27, 1922.
GEO. H. BROWN,
Of Counsel for Defendants.

127 [Endorsed:] (J.) #450. Eq. Norfolk Southern Railway Co. vs. A. D. Watts et —. Citation & Acceptance of Service. I certify that the within is entered and filed this day, Nov. 27, 1922. S. A. Ashe, Clerk.

Endorsed on cover: File No. 29,277. Eastern North Carolina D. C. U. S. Term No. 727. Norfolk Southern Railroad Company, appellant, vs. A. D. Watts, Commissioner of Revenue, and James S. Manning, Attorney General of the State of North Carolina. Filed December 11, 1922. File No. 29,277.



Office Supreme Court, U. S.

FILED

MAR 19 1923

WM. R. STANSBURY
CLERK

IN THE
Supreme Court of the United States

OCTOBER TERM, 1922.

No. 744.

SEABOARD AIR LINE RAILWAY
COMPANY, Appellant,

vs.

A. D. WATTS, INDIVIDUALLY AND AS
COMMISSIONER OF REVENUE OF
NORTH CAROLINA, ET AL., Appellees.

**Motion for Leave to Substitute R. A. Doughton,
Commissioner of Revenue of North Carolina, for
A. D. Watts, Commissioner of Revenue of North
Carolina.**

JAMES F. WRIGHT,
MURRAY ALLEN,
Attorneys for Appellant.

March 19, 1923.

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IN THE
Supreme Court of the United States

OCTOBER TERM, 1922.

No. 744.

SEABOARD AIR LINE RAILWAY
COMPANY, Appellant,

vs.

A. D. WATTS, INDIVIDUALLY AND AS
COMMISSIONER OF REVENUE OF
NORTH CAROLINA, ET AL., Appellees.

Comes the Appellant, Seaboard Air Line Railway Company, and moves the Court to substitute R. A. Doughton as one of the Appellees in this cause in place of A. D. Watts, and, for grounds of said motion, respectfully shows:

A. D. Watts, individually and as Commissioner of Revenue of the State of North Carolina, together with James S. Manning, Attorney General of North Carolina, were the original defendants herein. A. D. Watts resigned the office of Com-

missioner of Revenue on January 29, 1923, and was on January 29, 1923, succeeded in office by R. A. Doughton, who now holds said office.

Wherefore, Appellant prays that R. A. Doughton be substituted for A. D. Watts.

JAMES F. WRIGHT,
MURRAY ALLEN,
Attorneys for Appellant.

The undersigned, James S. Manning, Attorney General of the State of North Carolina, and representing R. A. Doughton, the present Commissioner of Revenue of North Carolina, consents for said R. A. Doughton to the substitution hereinabove moved for.

JAMES S. MANNING,
Attorney for R. A. Doughton.

FILED

MAR 19 1923

WM. R. STANSBURY
CLERK

IN THE
Supreme Court of the United States

OCTOBER TERM, 1922.

No. 727.

NORFOLK SOUTHERN RAILROAD
COMPANY, Appellant,
vs.

A. D. WATTS, INDIVIDUALLY AND AS
COMMISSIONER OF REVENUE OF
NORTH CAROLINA, ET AL., Appellees.

**Motion for Leave to Substitute R. A. Doughton,
Commissioner of Revenue of North Carolina, for
A. D. Watts, Commissioner of Revenue of North
Carolina.**

W. B. RODMAN,
Counsel for Appellant.

March 19, 1923.



IN THE
Supreme Court of the United States

OCTOBER TERM, 1922.

No. 727.

NORFOLK SOUTHERN RAILROAD
COMPANY, Appellant,

vs.

A. D. WATTS, INDIVIDUALLY AND AS
COMMISSIONER OF REVENUE OF
NORTH CAROLINA, ET AL., Appellees.

Comes the Appellant, Norfolk Southern Railroad Company, and moves the Court to substitute R. A. Doughton as one of the Appellees in this cause in place of A. D. Watts, and, for grounds of said motion, respectfully shows:

A. D. Watts, individually and as Commissioner of Revenue of the State of North Carolina, together with James S. Manning, Attorney General of North Carolina, were the original defendants herein. A. D. Watts resigned the office of Com-

missioner of Revenue on January 29, 1923, and was on January 29, 1923, succeeded in office by R. A. Doughton, who now holds said office.

Wherefore, Appellant prays that R. A. Doughton be substituted for A. D. Watts.

W. B. RODMAN,
Attorney for Appellant.

The undersigned, James S. Manning, Attorney General of the State of North Carolina, and representing R. A. Doughton, the present Commissioner of Revenue of North Carolina, consents for said R. A. Doughton to the substitution hereinabove moved for.

JAMES S. MANNING,
Attorney for R. A. Doughton.